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NO.

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

ROBINSON HUMPHREY/AMERICAN EXPRESS, INC. and SHEARSON/AMERICAN EXPRESS INC.,

Petitioners,

v.

GLENN T. SANDERS and LESLIE D. SANDERS, on behalf of themselves and all others similarly situated,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

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EDITOR'S NOTE

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QUESTIONS PRESENTED

1. Did the Court of Appeals err (a) in applying the fraud-on-the-market doctrine which eliminates the reliance requirement of Rule 10b-5, and (b) in extending the doctrine to cases involving the purchase of original-issue, fixed-price securities that are not traded on an active and developed market?

2. Did the Court of Appeals err in holding that, for purposes of deciding a motion for class certification, the District Court is required to accept as true all the allegations of the complaint, and may not weigh the record evidence in determining whether the movants have satisfied their burden of proving compliance with the requirements of Rule 23, Federal Rules of Civil Procedure?

RULE 28.1 LIST*

Non-Wholly-Owned Subsidiaries and Affiliates of Shearson Lehman Brothers Inc.

Active Subsidiaries

Boston Hambro Corp.
Boulevard Investors Inc.
Boulevard Real Estate Corp.
Burlington Investors Inc.
E.B. Realty
Lombard Realty Corporation
Lowell Investors Inc.
Lowell Real Estate Corp.
Shearson Dat-Cheong Company Limited
Shearson Lehman/Finanz AG
Shearson/KM, Inc.

Inactive Subsidiaries

Genex Insurance Brokerage Ltd.
Mideast-American, Inc.

Affiliates

California S.A.
Shearson Financial Services of Oklahoma, Inc.
Shearson Financial Services of Texas, Inc.
Shearson Lehman Brothers SARL
Intermodal Equipment Associates
KCC Syndicate Managers, Inc.
McLeod Young Weir Limited
New World Corporation
Rex Moor Properties Incorporated
Sovran Energy Corp.

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* All parties to the proceeding below are named in the caption. Petitioner Shearson Lehman Brothers Inc. was named in the complaint as Shearson/American Express Inc., and petitioner The Robinson-Humphrey Company, Inc. was named as Robinson Humphrey/American Express Inc.

Non-Wholly-Owned Subsidiaries and Affiliates of Shearson Lehman Brothers Holdings Inc., the Parent Company of Shearson Lehman Brothers Inc.*

American Express Asset Management Limited
American Express Asset Management N.V.
American Express Asset Management S.A.
American Express U.K. Holding Company Inc.
FGIC Corporation
Kuhn Loeb Lehman Brothers International B.V.
Lehman Brothers International UK Ltd.
Lehman International Finance N.V.
Lehman Overseas N.V.
LBKL 82-1 Investors Inc.
Shearson Lehman Broadgate North Inc.
Shearson Lehman Broadgate South Inc.

* The parent company of Shearson Lehman Brothers Holding Inc. is the American Express Company.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

Petitioners, The Robinson-Humphrey Company, Inc. ("Robinson-Humphrey"), successor to Robinson Humphrey/American Express, Inc., and Shearson Lehman Brothers Inc., successor to Shearson/American Express Inc., respectfully request that a writ of *certiorari* issue to review the judgment and opinion herein of the United States Court of Appeals for the Eleventh Circuit entered on September 15, 1987. Based on its holding that the "fraud-on-the-market" theory applies even to fixed-price, newly issued securities sold on an undeveloped market, the Eleventh Circuit, *inter alia*, reversed the district

court's rejection of the fraud-on-the-market theory in this case and its related denial of class certification of certain of respondents' federal securities claims.

OPINIONS BELOW

The opinion of the Court of Appeals for the Eleventh Circuit, captioned *Kirkpatrick v. J.C. Bradford & Co.*, is reported at 827 F.2d 718, and is reproduced at Appendix A hereto.[1] The three opinions of the United States District Court for the Northern District of Georgia, captioned *Sanders v. Robinson-Humphrey/American Express, Inc.*, are reported at [1986-87 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,880; 634 F. Supp. 1048;[2] and [1985-86 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,450. They are reproduced at Appendices B, C and D herein, respectively.

JURISDICTION

On September 15, 1987, the Eleventh Circuit entered a judgment and an opinion on respondents' appeal from the district court's denial of class certification. (*See* App. A.) The Appeals Court had accepted jurisdiction on this matter on August 21, 1986 pursuant to 28 U.S.C. § 1292(b). A copy of the order accepting jurisdiction is reproduced at Appendix E. Petitioners filed a suggestion for *in banc* rehearing, which, pursuant to Rule 35-6 of the Eleventh Circuit, automatically was treated as a petition for both panel and full-court rehearing. The Court of Appeals denied panel and *in banc* rehearing on October 21, 1987. A copy of the order denying rehearing is reproduced at Appendix F. On November 17, 1987, the Eleventh Circuit, on petitioners' motion pursuant to Fed. R. App. P. 41(b), stayed the issuance of its

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[1] The instant action and two similar Petro-Lewis actions, *Kirkpatrick v. J.C. Bradford & Co.* and *Parker v. PaineWebber Group, Inc.*, were considered jointly by the District Court for purposes of the class action determinations and by the Eleventh Circuit on plaintiffs' appeals; each court issued a consolidated opinion for all three cases.

[2] The opinion and order of the district court denying class certification, originally entered on March 27, 1986, was modified by order dated June 19, 1986. The text of the March 27 opinion, as reproduced in both Appendix C hereto and in the Federal Supplement, incorporates the modifications.

mandate "to and including November 23, 1987." A copy of the order staying the issuance of the mandate is reproduced at Appendix G. The jurisdiction of this Court to review the judgment of the Eleventh Circuit is invoked under 28 U.S.C. § 1254(1).

STATUTES AND RULES INVOLVED

The statutes and rules involved in the proceeding, which are set out in full at Appendix H, are Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78j(b); Securities and Exchange Commission Rule 10b-5 ("Rule 10b-5"), 17 C.F.R. § 240.10b-5; Sections 11, 12(2) and 15 of the Securities Act of 1933 (the "Securities Act"), 15 U.S.C. §§ 77k, 77*l*(2), 77o; and Rule 23, Federal Rules of Civil Procedure.

STATEMENT OF THE CASE

This action arises from the sale, through petitioner Robinson-Humphrey to respondents and other putative class members, of limited partnership interests issued by Petro-Lewis Corporation ("Petro-Lewis"). Respondents allege that Robinson-Humphrey's Petro-Lewis sales during the three-year purported class period violated various provisions of the federal securities laws, as well as state and common law. Respondents invoked the district court's jurisdiction under Section 27 of the Exchange Act, 15 U.S.C. § 78aa; Section 22 of the Securities Act, 15 U.S.C. § 77v; and under 28 U.S.C. § 1331 (general federal question jurisdiction) as well as principles of pendent jurisdiction.

A. *The Facts*

From 1970 to 1983, Petro-Lewis was the nation's largest seller of oil and gas income fund limited partnership interests, selling in excess of $3 billion worth. (App. C-2.) Petro-Lewis acquired oil and gas properties for public limited partnerships, shared ownership of those properties, and managed the limited partnerships as general partner. (*Id.*)

Petro-Lewis limited partnership interests were not publicly

traded; there was no active and developed trading market on which the interests could be purchased or sold. (*Id.* at 28.) Instead, an interested investor could purchase limited partnership interests from the issuer, Petro-Lewis, through any of numerous broker-dealers at an inflexible, fixed price which was set by Petro-Lewis. (*Id.*) Similarly, limited partners wanting to sell their interests had a limited right to present their interests to Petro-Lewis for repurchase, again at a price set not by any "market," but by Petro-Lewis. (*Id.*) Petro-Lewis limited partnership interests were not listed on any national or regional exchange, or any other trading medium.

Respondents purchased Petro-Lewis partnership interests through Robinson-Humphrey, a registered broker-dealer, on three occasions in 1981 and 1982. (App. D-2.) Respondents did not rely on any of the prospectuses issued in connection with these limited partnerships in making any of their Petro-Lewis investments; this is not disputed. In fact, respondents testified at deposition that they did not even *read* the prospectuses or any other written materials prior to making their three investments. (App. C-25-26 n.12.) Rather, respondents based their Petro-Lewis investment decisions on the oral recommendations and opinions of their broker, who had been a friend of Mrs. Sanders' family for many years prior to respondents' first purchase of Petro-Lewis limited partnership interests. (*Id.*)

In February 1984, Petro-Lewis announced that financial difficulties, precipitated by the world-wide decline of oil prices, had forced it to implement a series of dramatic economy measures. These measures included reducing partnership distributions by as much as 50 per cent and selling between one-quarter and one-third of Petro-Lewis' oil and gas reserves. (*Id.* at 2-3.) The misfortunes of Petro-Lewis, well-publicized and widely followed, prompted the filing of numerous lawsuits.

Eleven consolidated class actions in Colorado filed by investors against Petro-Lewis and its officers and directors, but in which brokerage firms like petitioners were not named as defendants, were settled in late 1984, after stipulated class certification for settlement purposes. *See In re Petro-Lewis Securities Litigation*,

[1984-85 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,899 (D. Colo. 1984). The cornerstone of the settlement was the formation of the American Royalty Trust (the "Trust"). Under the settlement, the Petro-Lewis limited partnership interests and their related assets were acquired from the settling class members in return for Trust units. In its opinion approving creation of the Trust as part of the settlement, the Colorado district court noted that a key advantage of the Trust structure was that these new Trust units, unlike the original limited partnership interests, would be listed on the American Stock Exchange; thus, as of 1985, for the *first* time, a true "market" would exist for the Petro-Lewis partnership-based securities which would "provide new liquidity" to the settling investors. (*Id.* at 90,468.) Pursuant to the Colorado settlement, respondents herein eventually received Trust units in exchange for their partnership interests.

Respondent Glenn Sanders commenced the instant action on January 25, 1985, subsequent to the Colorado settlement. The complaint was amended on October 17, 1985 to add Mrs. Sanders as plaintiff.

B. *The District Court's Class Certification Opinions*

A class certification motion was filed on April 25, 1985; respondents sought to represent a class of investors who purchased the original Petro-Lewis limited partnership interests through petitioners from January 1, 1981 through February 6, 1984. (App. C-5.) Under extensive briefing both before and after an evidentiary hearing on Rule 23 issues, the district court denied class certification. (*See* App. C.) On respondents' motion for reconsideration, and after still further briefing, the district court reaffirmed its order, and certified an interlocutory appeal pursuant to 28 U.S.C. § 1292(b). (*See* App. B.)

The district court's orders denying class certification were based on a number of independent grounds, only one of which is germane to this petition – respondents' failure to meet the Rule 23(b)(3) predominance requirement. The district court held that because, *inter alia*, respondents admittedly had relied on the oral

statements of their personal broker rather than on the prospectuses or other written materials relating to the Petro-Lewis limited partnerships, respondents' Rule 10b-5 claims raised individualized questions of reliance that would predominate over common questions of law and fact. (App. C-29.) The trial court ruled that respondents were not entitled to a presumption of reliance under any version of the fraud-on-the-market theory or under the rule established in *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972). (App. C-29.) Thus, the court held that class treatment of the Rule 10b-5 claims was barred by respondents' failure to satisfy their Rule 23(b)(3) burden of proving that common questions would predominate over individualized questions.

C. *The Opinion Of The Eleventh Circuit Court Of Appeals*

The appellate court's September 15, 1987 opinion affirmed the denial of class certification of the state and common law claims; however, the panel reversed the district court's holding that class treatment of the federal securities law claims was barred by Rule 23(b) predominance considerations. (App. A.)

In reversing the lower court, the panel held that the Rule 10b-5(1) and 10b-5(3) claims were certifiable on the sole ground that those claims, as pleaded, entitled respondents to be excused from proving reliance affirmatively pursuant to the so-called fraud-on-the-market exception announced in *Shores v. Sklar*, 647 F.2d 462 (5th Cir. May 1981) (*en banc*), *cert. denied*, 459 U.S. 1102 (1983). (App. A-6, 7.) In its 12-10 *en banc* decision, the *Shores* court became the first to apply the fraud-on-the-market theory to a purchase or sale of securities in an *un*developed market.[3]

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[3] Both the district court and the panel were bound by and constrained from reexamining *Shores*. *See Bonner v. City of Prichard*, 661 F.2d 1206, 1209-10 (11th Cir. 1981) (*en banc*). In denying petitioners' Suggestions For Rehearing *In Banc*, the Eleventh Circuit *in banc* effectively refused to review the ongoing vitality of *Shores*.

Stating that the securities laws "cover deliberate, manipulative schemes to defraud which can annul . . . the *market's honest function*," 647 F.2d at 464 (emphasis added), *Shores* held that Rule 10b-5 reliance may be established sufficiently by proof that the plaintiff "reasonably relied on the [securities'] availability on the market as an indication of their apparent genuineness," *id.* at 469-70. As applied by the panel herein, this fraud-on-the-*un*developed-market theory allows a class representative to invoke its reliance presumption to establish Rule 23 predominance.

Under *Shores*, reliance will be deemed established in an undeveloped-market context only if the securities at issue "were not entitled to be marketed" at all. *Id.* at 469; *see also* App. A-7, 8. Thus, if a plaintiff "proves no more than that the [securities] would have been offered at a lower price . . . rather than that they would never have been issued or marketed, he cannot recover" under the fraud-on-the-*un*developed-market theory. *Shores*, 647 F.2d at 470.

The panel in the instant action further stated that under the *Shores* doctrine, a plaintiff's reliance on the market need not be the exclusive or even primary basis for his purchase of securities in order for him to get the benefit of the presumption. (App. A-8.) As long as he placed any amount of faith in the mere *availability* of the security to the public, a claimant may proceed on a fraud-on-the-market theory even if he relied primarily on other factors in making his investment decisions. (*Id.*)

Additionally, the panel agreed with the district court that the Rule 10b-5(2) claims would require individualized proof of reliance. (*Id.* at 10-11.) Nevertheless, the panel held that the Rule 23(b)(3) predominance requirement was satisfied by virtue of the fact that the complaint "alleges 'a single conspiracy and fraudulent scheme against a large number of individuals' and thus is 'particularly appropriate for class action.' " (*Id.* at 10 (quoting *Kennedy v. Tallant*, 710 F.2d 711, 718 (11th Cir. 1983)).) This was the sole ground for the reversal of the district court's determination that common issues would not predominate with respect to the 10b-5(2) claims.

REASONS FOR GRANTING THE WRIT

I.

APPLICATION OF THE FRAUD-ON-THE-MARKET THEORY IS AN ISSUE WHICH THIS COURT ALREADY HAS DEEMED TO BE OF SUFFICIENT MOMENT TO WARRANT REVIEW ON *CERTIORARI*

This petition seeks review of the so-called "fraud-on-the-market" doctrine, in particular (i) the doctrine's effective elimination of the traditional Rule 10b-5 requirement that plaintiffs plead and prove reliance on alleged misstatements,[4] and (ii) its widespread use as a vehicle for circumventing the Rule 23(b)(3) predominance test. This petition raises issues that are substantially identical to those asserted in the context of developed-market securities transactions by the petitioners in *Basic Inc. v. Levinson*, 107 S. Ct. 1284 (1987), *granting cert. to*, 786 F.2d 741 (6th Cir. 1986), a case now *sub judice* before the Court.[5]

This Court granted *certiorari* in *Basic Inc.* in order to address, *inter alia*, the legitimacy of the fraud-on-the-market theory in an open-market context. *Basic Inc.* involved claims by a putative class of sellers of the common stock of Basic Incorporated ("Basic") that the price at which Basic shares were traded on the New York Stock Exchange was artificially depressed due to certain allegedly misleading public statements issued by Basic. On the basis of these

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[4] In order to avoid repetition, petitioners use the term "misstatements" to refer to misrepresentations, omissions, and any device, scheme or other means by which a defendant is alleged to make fraudulent disclosures or nondisclosures of material information.

[5] Because so many class actions are settled before final judgment, the fraud-on-the-market theory has eluded this Court's review despite its vital importance. This Court granted *certiorari* in order to review the doctrine as early as 1982; however, that case was vacated as moot when the plaintiff-respondent withdrew the lawsuit prior to argument. *Panzirer v. Wolf*, 663 F.2d 365 (2d Cir. 1981), *cert. denied on class action issues*, 458 U.S. 1107, *cert. granted on other issues*, 458 U.S. 1105, *vacated as moot*, 459 U.S. 1027 (1982).

fraud-on-the-market allegations, the district court certified a class of sellers of Basic shares, but explicitly noted that, absent a presumption of reliance, denial of class certification would have been required under Fed. R. Civ. P. 23(b)(3). After discovery, the district court granted summary judgment for defendants. Plaintiffs appealed, and defendants cross-appealed the order granting class certification. The Sixth Circuit Court of Appeals reversed the order granting summary judgment but affirmed class certification, noting with approval the district court's application of a fraud-on-the-market presumption of reliance "[t]o circumvent what the district court perceived to be a barrier to class actions in 10b-5 cases . . . ." *Levinson v. Basic Inc.*, 786 F.2d 741, 749-50 (6th Cir. 1986), *cert. granted*, 107 S. Ct. 1284 (1987).

The instant petition, like that in *Basic Inc.*, asks the Court to resolve the important question of whether the fraud-on-the-market theory properly may be invoked to subvert the long-standing Rule 10b-5 reliance requirement, and thereby provide a shortcut to class certification. If this Court rejects the theory in the traditional, developed-market context presented in *Basic Inc.*, the instant case will require, at a minimum, remand to the Court of Appeals for reconsideration in light of that opinion. Clearly, the more extreme version of the fraud-on-the-market theory created by *Shores* and applied in this case could not survive a holding in *Basic Inc.* that rejected fraud-on-the-market in the developed-market context. Thus, this Court should grant the instant petition on grounds that it presents a case which is closely related to, and potentially controlled by, *Basic Inc.*

II.

INDEPENDENTLY, THE VALIDITY OF THE ELEVENTH CIRCUIT'S ABANDONMENT OF THE RULE 10b-5 RELIANCE REQUIREMENT IN THE CONTEXT OF UNDEVELOPED, NON-EFFICIENT MARKETS IS AN ISSUE OF IMPERATIVE NATIONAL IMPORTANCE

Even assuming the validity of the fraud-on-the-market doctrine as applied to open-market transactions, the instant petition should be granted so that this Court may consider the validity of that theory in its most extreme form — the *Shores* application of the doctrine to undeveloped markets.

The Eleventh Circuit's extension of the fraud-on-the-market doctrine to undeveloped markets takes the instant case beyond even the questionable theoretical underpinnings of fraud-on-the-market as applied in *Basic Inc.* Unlike Basic securities which were traded on the New York Stock Exchange, Petro-Lewis limited partnership interests were not listed on the New York, American, or any of the regional stock exchanges, nor were they traded on *any* market on which prices arguably fluctuate in supposed response to available information. Rather, Petro-Lewis interests were purchased from, and on occasion were resold (by redemption) to, Petro-Lewis. These securities never were "traded" at all, certainly not in the sense of trading on an active, price-sensitive market.

This distinction makes the instant case an even *more* compelling candidate than *Basic Inc.* for this Court's review.[8] At a minimum, the developed-market/undeveloped-market distinction makes this case an important complement to *Basic Inc.* While rejection of the fraud-on-the-market doctrine in *Basic Inc.* necessarily would

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[8] The *amicus* brief of the Securities and Exchange Commission ("SEC") in the *Basic Inc.* proceeding similarly draws a distinction between the two versions of the fraud-on-the-market theory, and expressly declines to address the merits of the theory in the undeveloped-market context. *See* Brief for the Securities and Exchange Commission as *Amicus Curiae*, *Basic Inc. v. Levinson*, No. 86-279 (U.S.) ("SEC Br.") at 22 n.26.

compel rejection of the doctrine in the context of the undeveloped markets for unlisted, untraded securities such as Petro-Lewis interests, a contrary finding in *Basic Inc.* would leave unaddressed the much more controversial question of the doctrine's validity in this closely related, companion area. Thus, granting the requested writ will permit the Court to deal with the full scope of the fraud-on-the-market theory as it is being applied by the lower courts.

A. *The Fraud-On-The-Undeveloped-Market Theory Lacks Even The Tenuous Foundations Of Its Developed-Market Counterpart*

Proponents of the traditional, developed-market fraud-on-the-market theory justify the doctrine in two ways. First, they claim theoretical economic support for the doctrine in the "efficient market hypothesis." Second, they disclaim subversion of the reliance requirement, arguing that the rebuttable presumption created by the doctrine "merely" effects a reallocation of the burden of proof, not an elimination of the reliance element of the cause of action. The fraud-on-the-*un*developed-market theory, however, cannot be buttressed by either of those two arguments.

1. *There is no principled basis in law or economics for the extension of the fraud-on-the-market theory to undeveloped, non-efficient markets*

The fraud-on-the-*un*developed-market theory, while sweeping in scope, is wholly devoid of any sound rationale. The theoretical foundation for the traditional fraud-on-the-market theory (of the *Basic Inc.* variety) is the "efficient market hypothesis," an economic theory of market behavior which, by definition, is inapplicable to *un*developed markets.[7] As the SEC explained in its friend-of-the-court brief in *Basic Inc.*,

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[7] The efficient market hypothesis focuses on the supposed valuation functions of a developed market, such as the national exchanges, and holds that the price

(footnote continued on next page)

> [t]he fraud on the market theory rests on two propositions: that in an *active secondary market the price of a company's stock* is determined by all material information available regarding the company and its business; and that investors rely on the integrity of market *prices* when making investment decisions. These propositions together establish that such investors rely, albeit indirectly, on material misrepresentations concerning *actively traded* securities.

SEC Br. at 22 (emphasis added) (citations omitted). The SEC's synopsis properly identifies the critical element upon which the entire doctrine turns: the existence of active, price-sensitive secondary markets on which the securities are traded. In the absence of such a market, the fundamental underpinning of the fraud-on-the-market theory is missing, and the theory must fail.

Manifestly, even the "traditional" fraud-on-the-market theory is sufficiently controversial to have warranted *certiorari* in *Basic Inc.* The Eleventh Circuit, however, has extended the doctrine's already attenuated justifications beyond all economic or legal realities by applying the doctrine to non-efficient, undeveloped markets. The efficient market hypothesis, the very heart of the fraud-on-the-market theory, does not operate where the market is *un*developed. *E.g.*, Note, *The Fraud-on-the-Market Theory*, 95 Harv. L. Rev. 1143, 1161 (1982) ("[B]ecause it is at best uncertain whether undeveloped markets are efficient, the fraud-on-the-market theory should not be applied to them in any form.").

(footnote continued from previous page)
at which a security is traded on such a market reflects all available material information bearing on that security. Market participants assemble and analyze the public information and, by trading in reliance on that information, place upward or downward pressure on a security's price. Theoretically, then, the resultant price represents the fair and true value of the security as long as the information in the market is complete and correct. *See generally Peil v. Speiser*, 806 F.2d 1154, 1160-61 (3d Cir. 1986); *In re LTV Securities Litigation*, 88 F.R.D. 134, 142-45 (N.D. Tex. 1980); Note, *The Fraud-on-the-Market Theory*, 95 Harv. L. Rev. 1143, 1153-56 (1982).

By definition, in the undeveloped-market setting there is no market on which an investor relies to assimilate and transmit alleged misstatements by means of a distorted market price. There can be no distortion of the pricing function where price is set not by an impersonal market, but by the issuer itself. Without a price-elastic market acting as an investor's "agent" for valuation purposes, the investor himself cannot logically escape the necessity of proving his actual reliance on alleged misstatements as a prerequisite to a Rule 10b-5 recovery. Commentators, recognizing this, thus have criticized as unprincipled both the fraud-on-the-*un*developed-market doctrine generally and the *Shores* opinion specifically. *See, e.g.*, Black, *Fraud on the Market: A Criticism of Dispensing with Reliance Requirements in Certain Open Market Transactions*, 62 N.C.L. Rev. 435, 453 (1984); Note, *The Fraud-on-the-Market Theory*, 95 Harv. L. Rev. at 1156-58.

The fraud-on-the-*un*developed-market theory not only *lacks* the supporting rationale which underlies its open-market counterpart; it *conflicts* with it. Indeed, most Courts of Appeals expressly hold that the fraud-on-the-market theory has no application where markets are non-efficient: proof that the efficient market hypothesis is inoperative with respect to a particular security is held to *remove* a given case from the ambit of the traditional fraud-on-the-market theory.[8] And a number of courts, some explicitly referring to *Shores*, have observed that the traditional theory's rationale does not necessarily provide any support for the undeveloped-market variant. *See, e.g., Peil v. Speiser*, 806 F.2d 1154, 1161 n.10 (3d Cir. 1986); *Basic Inc.*, 786 F.2d at 751 (distinguishing situations not involving "an impersonal exchange in the open market"); *see also In re LTV Securities Litigation*,

[8] Thus, the courts uniformly allow defendants to rebut the reliance presumption by showing, *inter alia*, "that the market price did not reflect the corporate statements" alleged to be actionable. SEC Br. at 22 n.26; *see, e.g., Peil v. Speiser*, 806 F.2d 1154, 1161 (3d Cir. 1986); *Basic Inc.*, 786 F.2d at 750 n.6; *Blackie v. Barrack*, 524 F.2d 891, 906 (9th Cir. 1975), *cert denied*, 429 U.S. 816 (1976). In other words, an open-market defendant is allowed to defeat the presumption by proving that which is *always* true in fraud-on-the-*un*developed market cases.

88 F.R.D. 134, 146 (N.D. Tex. 1980); *Svenningsen v. Piper, Jaffray & Hopwood, Inc.*, [1986-87 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,854 at 94,149 (D. Minn. 1986).

The instant case is a textbook example of why the fraud-on-the-market theory lacks any theoretical or logical basis in the context of an undeveloped market. Here, it is undisputed (and disclosed in the prospectuses) that the price of Petro-Lewis partnership interests was established exclusively by the issuer and did not fluctuate at *all* in the manner of actively traded securities. The fraud-on-the-market theory espoused by *Shores* and applied herein thus does not supply even the strained justification that arguably is present in the open-market context for circumventing the reliance requirement in Rule 10b-5 cases.

Therefore, even if the fraud-on-the-market theory is held by this Court to play a legitimate role in the open-market context — petitioners, like Basic, believe it does not — the Eleventh Circuit's extension of that theory beyond the boundaries of any colorable theoretical foundation nevertheless would warrant separate consideration by this Court. The question of the validity of the fraud-on-the-market theory — of imperative national significance even in the traditional context of developed markets — takes on even more sweeping but less justifiable dimensions when the theory is transplanted into undeveloped markets.

2. *The Eleventh Circuit's fraud-on-the-undeveloped-market doctrine effects an unreasonable abandonment of the Rule 10b-5 reliance requirement*

As traditionally applied, the fraud-on-the-market theory purports to be nothing more than an evidentiary rule allocating the burden of proving reliance. The *Basic Inc.* petitioners argue, with merit, that despite the case law holding the traditional fraud-on-the-market reliance presumption to be rebuttable, any theoretical right to offer a rebuttal is illusory in most cases, especially in large class actions.

Defendants confronted with the *un*developed-market version of the theory fare even worse. Despite the absence of a logical foundation, the fraud-on-the-*un*developed-market theory effectively eliminates reliance as a substantive element of the Rule 10b-5 cause of action. Upon a showing that the securities at issue were not "entitled to be marketed," not only are plaintiffs excused from proving affirmative reliance, but defendants cannot even overcome the "presumption" with direct evidence of *non*-reliance. For all practical purposes, the Eleventh Circuit has created by judicial fiat a substantive rule of law sanctioned neither by this Court nor by Congress.

The original, developed-market version of fraud-on-the-market allows defendants to defeat the presumption of reliance in one of at least two ways: by showing (i) that the price of the securities at issue was not affected by the alleged misstatements, *i.e.*, the market was not efficient, or (ii) that the plaintiffs relied on factors other than the integrity of the market when making their investments. *See, e.g., Peil*, 806 F.2d at 1161; *Kline v. Wolf*, 702 F.2d 400, 403 (2d Cir. 1983); *Blackie v. Barrack*, 524 F.2d 891, 906 (9th Cir. 1975), *cert. denied*, 429 U.S. 816 (1976). Neither form of rebuttal is afforded by the Eleventh Circuit's extension of fraud-on-the-market into undeveloped markets.

In the context of an undeveloped market, which by definition is inefficient, the first rebuttal option — showing the inefficiency of the market — is simply not permitted. If it were otherwise, the "presumption" automatically would be rebutted. In this respect, the two versions of the fraud-on-the-market theory actually *conflict*.

Second, the panel here also rejected expressly, albeit on unarticulated grounds, the second rebuttal avenue — proving that a plaintiff actually relied on other, non-"market" factors. (*See* A-9.) The panel opinion thereby stands in conflict with the extensive line of cases holding that the fraud-on-the-market reliance presumption may be rebutted by proof that the plaintiff relied on factors other than the market's integrity. Thus, as predicted by the ten *Shores* dissenters, the fraud-on-the-*un*developed-market rule has done far more than merely shift the burden of proving

reliance: it has made the "presumption" irrebuttable and eliminated as a matter of substantive law the long-standing reliance element of Rule 10b-5(1) and (3) causes of action. *See, e.g., Shores*, 647 F.2d at 476-77, 479 (Randall, J., dissenting).

As the papers filed with this Court in *Basic Inc.* demonstrate, the language and structure of the securities statutes do not allow for such extreme and unprincipled excisions of basic elements of a claim for relief based on those laws.[9] Reliance and the related element of causation are all that distinguish Rule 10b-5 from an insurance plan for disappointed investors, something Congress never intended to adopt. *See, e.g., List v. Fashion Park, Inc.*, 340 F.2d 457, 462-63 (2d Cir.), *cert. denied*, 382 U.S. 811 (1965).

B. *The Distinction Between So-Called "Marketable" And "Unmarketable" Securities, Which Is The Sole Rationale For The* Shores *Doctrine, Is Unprincipled And Contrary To The Fundamental Structure Of The Federal Securities Laws*

The fraud-on-the-*un*developed-market theory's lack of legal or theoretical merit is epitomized by the distinction it draws between so-called marketable and unmarketable securities. *See* p. 7 *supra*. That distinction, on which the entire doctrine purports to turn, is illusory.

1. *The notion that securities can be "unmarketable" is alien to the federal securities laws*

As the *Shores* dissenters note, the purpose of the federal securities laws is to require full and truthful disclosure, not to

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[9]*See* Brief *Amici Curiae* of Arthur Andersen & Co., *et al.*, in Support of Petitioners, *Basic Inc. v. Levinson*, No. 86-279 (U.S.) at 4-9; Brief of American Institute of Certified Public Accountants as *Amicus Curiae* in Support of Petitioners, *Basic Inc. v. Levinson*, No. 86-279 (U.S.) at 6-15. In light of the extensive discussion of the statutory scheme and legislative history of the securities acts presented in *Basic Inc.*, and argued only days ago on November 2, 1987, petitioners will not burden the Court with a reiteration of those points.

pass on the merit or prospects of particular securities. 647 F.2d at 482; *see also Santa Fe Industries v. Green*, 430 U.S. 462, 477-78 (1977). Indeed, the principles underlying the federal securities laws hold that *any* security is "entitled to be marketed" as long as all material information relating to it is fully disclosed; even a security which is so lacking in prospects as to appear valueless to the reasonable investor may be "marketed" as long as potential investors are told the truth about it. Members of the public then are free to make their own informed decisions regarding whether they wish to buy what is offered. Liability under Rule 10b-5 is based only on intentionally *false disclosures* upon which investors rely to their detriment. Thus, the central premise set up by *Shores*, that there is some category of securities which are "not entitled to be marketed," is contrary to the central premise of the federal securities statutes. Yet *Shores* itself acknowledges that without drawing this dichotomy the fraud-on-the-*un*developed-market doctrine could not exist. *Shores*, 647 F.2d at 470.[10]

2. ***The "unmarketability" test is an inadequate substitute for the critical element of reliance***

The reliance requirement swept away by *Shores* and the panel opinion herein supplies an essential limitation on the scope of Rule 10b-5 causes of action. Specifically, reliance is the link in the logical chain necessary (a) to establish that a particular defendant's alleged misstatements *in fact caused* a claimant's injury, and, concomitantly, (b) to ensure that Rule 10b-5 is not transformed into an "insurance plan" for disappointed investors. *See, e.g.*, *List*, 340 F.2d at 462-63. The fraud-on-the-*un*-developed-

[10] In effect, the Eleventh Circuit, in adopting *Shores*, has elevated a difference in degree of injury to a difference in kind that defines the substantive *elements* of the cause of action. This leads to anomolous results. For example, the *Shores* doctrine holds that a person who pays 10 dollars for a share of stock which would be worth nothing if the alleged fraud had not occurred would be excused from proving reliance, while another person who paid 20 dollars for a different stock actually worth one dollar would be required to prove affirmatively his direct reliance on specific misstatements. There is no principled basis for such a distinction.

market theory, by removing the causal link of reliance, disposes of a key limitation on otherwise boundless potential liability under Rule 10b-5.

The *Shores* doctrine supplies no effective replacement for actual reliance. The "but-for" causation sanctioned by *Shores* and applied by the panel here (but for the fraud, the securities could not have been marketed) fails to establish causation *in fact*.[11] Proof that a security would have been unavailable "but for" a defendant's alleged misstatements is *not* the functional equivalent of reliance on those misstatements. At most, such proof would establish only that an individual investor would not have had the *opportunity* to rely on those misstatements if the securities had not been marketed.

Rule 10b-5, however, requires more — specifically, a showing that the misstatements in fact *were* relied upon and therefore *caused* the injury. As this Court has recognized, an investor seeking to recover under Rule 10b-5 must establish "*causation in fact*." *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 154 (1972) (emphasis added). The panel's elimination of this requirement by relieving Rule 10b-5 plaintiffs in the Eleventh Circuit of any obligation to prove reliance plainly contravenes this mandate and warrants the Court's review.

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[11] The panel's decision specifically recognizes that the *Shores* doctrine at best establishes mere "but-for" causation, without recognizing that "but-for" causation is no adequate substitute for causation in fact, which can be established only by reliance:

> A *Shores* fraud-on-the-market claim thus is especially suited for class action treatment, as it makes virtually irrelevant the possibility that the various purchasers may have relied on different representations regarding the desirability of the particular security in question: all have relied on the integrity of the market in the *but-for* sense required by *Shores*.

(App. A-9 (emphasis added).)

III.

BY RELIEVING CLASS ACTION PLAINTIFFS OF THEIR RULE 23 BURDEN OF PROOF AND LIMITING THE DISTRICT COURT'S INQUIRY TO THE FACE OF THEIR COMPLAINTS, THE ELEVENTH CIRCUIT'S OPINION CONFLICTS WITH PRECEDENT AND ALSO RAISES AN IMPORTANT QUESTION CALLING FOR THE EXERCISE OF THIS COURT'S SUPERVISORY POWERS

In the very first paragraph of their Argument to the Eleventh Circuit, respondents urged reversal on the grounds that the district court was required to limit its class certification inquiry to the *allegations* of their complaint, and that the lower court therefore erred by considering *facts* relating to the class certification issue. *See* Brief of Glenn T. Sanders and Leslie D. Sanders, Appellants at 20-21. Despite the body of controlling law to the contrary, respondents' position prevailed before the Eleventh Circuit.

It is well settled that a moving plaintiff must carry the burden of establishing *each* of the Rule 23 class action requirements. *See, e.g., General Telephone Co. v. Falcon*, 457 U.S. 147, 156 (1982); *Love v. Turlington*, 733 F.2d 1562, 1564 (11th Cir. 1984); *Bishop v. Committee on Professional Ethics and Conduct of the Iowa State Bar Ass'n*, 686 F.2d 1278, 1288 (8th Cir. 1982); *Zeidman v. J. Ray McDermott & Co.*, 651 F.2d 1030, 1038 (5th Cir. Unit A 1981). Similarly, it is this Court's long-standing rule that a trial court may, and often must, turn to the factual record to determine whether the movant has carried his burden of proof.

> As we noted in Coopers & Lybrand v Livesay, 437 US 463, 57 L Ed 2d 351, 98 S Ct 2454, '*the class determination generally involves considerations that are "enmeshed in the factual and legal issues comprising the plaintiff's cause of action.*" ' Id., at 469, 57 L Ed 2d 351, 98 S Ct 2454 (quoting Mercantile Nat. Bank v Langdeau, 371 US 555, 558, 9 L Ed 2d 523, 83 S Ct 520). Sometimes the issues are plain enough from

> the pleadings to determine whether the interests of the absent parties are fairly encompassed within the named plaintiff's claim, and *sometimes it may be necessary for the court to probe behind the pleadings* before coming to rest on the certification question.

Falcon, 457 U.S. at 160 (emphasis added);[12] *see also McCarthy v. Kleindienst*, 741 F.2d 1406, 1414 n.8 (D.C. Cir. 1984); *Morrison v. Booth*, 730 F.2d 642, 643 (11th Cir. 1984); *Sirota v. Solitron Devices, Inc.*, 673 F.2d 566, 571 (2d Cir.), *cert. denied*, 459 U.S. 838 (1982).

Thus, the district court acted well within the bounds of Rule 23 precedent when, while addressing respondents' effort to meet the Rule 23(b)(3) predominance requirement, it openly considered matters of record beyond the face of the pleadings. Finding on the basis of facts adduced during discovery and at an evidentiary hearing that respondents had failed to make any showing that Petro-Lewis interests were "not entitled to be marketed," the trial court held that respondents could not resort to the *Shores* fraud-on-the-*un*developed-market reliance presumption in order to satisfy their Rule 23 burden of proving predominance. Likewise, the district court determined on the basis of record evidence that because the alleged misrepresentations were primarily oral, each putative class member would be required to prove individual reliance. Hence, individual issues would predominate.

The panel reversed the district court on both of these issues, but not on any finding that the district court's factual determinations were clearly erroneous. Rather, error was found in the fact that the district court endeavored to make such a determination *at all* rather than simply accept the unsupported allegations of the complaint. Addressing respondents' Rule 10b-5(1) and (3) claims, the panel stated:

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[12] Indeed, these principles, discussed by the Court in *Falcon* in the context of Rule 23(a)(4) inquiries, are of even greater relevance here because, as this Court observed in *Coopers & Lybrand v. Livesay*, the " 'more complex determinations required in Rule 23(b)(3) class actions entail even greater entanglement with the merits . . . .' " 437 U.S. at 469 n. 12 (quoting 15 C. Wright, A. Miller, & E. Cooper, *Federal Practice & Procedure* § 3911, p. 485 n.45 (1976)).

> Here, consistent with *Shores*, *plaintiffs alleged* that the Petro-Lewis shares, which were not traded on the open market, could not have been marketed but for the defendants' fraud.
>
> In rejecting this claim as improper for class treatment, *the court relied solely on its conclusion that the plaintiffs' allegations lacked evidentiary support.* Despite the court's assertions to the contrary, *this determination was an inappropriate inquiry into the merits* of the plaintiffs' claims.

(App. A-7 (emphasis added).) Similarly, with respect to respondents' Rule 10b-5(2) claims, the panel concluded that the allegation of a "common course of [fraudulent] conduct" was sufficient, regardless of considerations of proof, to warrant class certification. (*Id.*) Thus, according to the panel, the mere *allegations*, however unsupported, that Petro-Lewis interests were inherently unmarketable and that petitioners engaged in a course of fraudulent conduct "common" to each member of the purported class, were sufficient to *require* class certification.

In so holding, the panel below has eliminated the district courts' traditional discretion to determine, as a matter of fact, whether class action plaintiffs have met the requirements of Rule 23, and has shackled the district courts to the mere allegations of the complaints. Moreover, the panel thereby has relieved the moving parties of their burden of *proving* (as opposed to merely alleging) Rule 23 compliance, while at the same time disabling the opposing parties from disproving Rule 23 compliance with *facts*.

There is no sound basis, statutory or otherwise, for affording a plaintiff all the power and leverage of the class action device — to say nothing of *requiring* that a district court do so — unless and until he meets the Rule 23 test not by mere allegation, but by a *prima facie* factual showing. Indeed, the propriety of a court's review of the full state of the record is not only confirmed by the prior holdings of this Court, it is also implicit in Rule 23(c)(1), which empowers the district courts to modify their class determinations pursuant to the evolving state of the record throughout the course of the litigation. The holding below plainly

expresses the Eleventh Circuit's support for class actions on "policy" grounds, but it runs afoul of this Court's holdings which require a plaintiff to *prove* his entitlement to class certification, as well as the decisions noted below which cast serious doubt on the social desirability of such a "policy." This unprincipled and far-reaching departure from settled Rule 23 law by a federal Court of Appeals requires review by this Court, lest it be applied in the countless class actions which, as is common, will be settled for inflated sums and never reach this Court for review.

IV.

THE PANEL OPINION CONFLICTS WITH THE PRONOUNCEMENTS OF THIS AND LOWER COURTS FORBIDDING THE UNREASONABLE EXTENSION OF THE RULE 10b-5 CAUSE OF ACTION AND EXPANSION OF PLAINTIFF CLASSES

Only rarely will fraud-on-the-*un*developed-market cases reach trial. Faced with the abandonment of the reliance requirement and a class so broad that defendants are exposed to potential judgments exceeding many times over any appropriate liability, many class action defendants will deem the risks and expense of class litigation too high, and will settle regardless of the merits of the claims. The Eleventh Circuit's rule thus creates a hospitable environment for strike suits.

As discussed above, elimination of the requirement to show actual reliance severs the only direct causal tie between a defendant's alleged misstatements and the plaintiff-investor's investment decision. Comparable efforts to expand the ambit of Rule 10b-5 liability have been rejected by this Court in the past. *See, e.g., Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976) (reaffirming the restrictive *scienter* requirement); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975) (holding that the "in connection with" requirement limits standing to sue). This Court has explained its unwillingness to open the floodgates to Rule 10b-5 actions that are unconstrained by the traditional elements of that cause of action by stating that:

> to the extent [an expanded view of Rule 10b-5 standing] permits a plaintiff with a largely groundless claim to simply take up the time of a number of other people, with the right to do so representing an in terrorem increment of the settlement value . . . it is a social cost rather than a benefit. Yet to broadly expand the class of plaintiffs who may sue under Rule 10b-5 would appear to encourage the least appealing aspect of the use of the discovery rules.

Blue Chip Stamps, 421 U.S. at 741.[13]

In a similar vein, this Court has identified the precise danger inherent in tipping the scales in favor of rubber stamp certification of Rule 23 classes:

> Certification of a large class may so increase the defendant's potential damages liability and litigation costs that he may find it economically prudent to settle and to abandon a meritorious defense.

Coopers & Lybrand v. Livesay, 437 U.S. 463, 476 (1978).

Despite these precedents, the Eleventh Circuit's ruling has broadened immeasurably both the Rule 10b-5 cause of action and the class of investors which may pursue such a claim. The risks faced by defendants in contemplation of trial, and the pressures to settle the action, are multiplied correspondingly. The odds having been stacked against them, many defendants will settle even those fraud-on-the-*un*developed-market suits which are wholly lacking in merit. Since the pressures to do so derive from the Eleventh Circuit's unprincipled dilution of the proof

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[13] This Court also referred in *Blue Chip Stamps* to the possibility that unduly extensive imposition of civil liability under Rule 10b-5 " 'will lead to large judgments, payable in the the last analysis by innocent investors, for the benefit of speculators and their lawyers;' " the Court futher noted the "widespread recognition that litigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general." 421 U.S. at 739 (1975) (quoting *S.E.C. v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 867 (2d Cir. 1968) (Friendly, J., concurring)).

required in Rule 10b-5 cases, coupled with its impermissible skewing of established Rule 23 procedures in favor of class plaintiffs, this Court's review is imperative.

Time and again, the fraud-on-the-market doctrine is invoked by plaintiffs who never *read*, let alone relied upon, the alleged misstatements of which they complain. Under the prevailing fraud-on-the-market doctrine, this approach enables plaintiffs not merely to avoid dismissal of their own defective claims, but indeed to support their use of Rule 23 to expand such claims into the blunt instrument of a class action. The perversity of such a practice, its pervasive use in nearly every major securities litigation, and the ability of the fraud-on-the-market doctrine to elude this Court's review since *certiorari* was first granted to review it five years ago, strongly supports the granting of this petition.

CONCLUSION

For all of the foregoing reasons, petitioners respectfully urge the Court to grant this petition and issue a writ of *certiorari* to the United States Court of Appeals for the Eleventh Circuit in order to address these issues of national importance.

Dated: New York, New York
November 23, 1987

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APPENDIX

Suzanne KIRKPATRICK; Dorothy D. Casler and Charles H. Lindsey, on behalf of themselves and all others similarly situated,

Plaintiffs-Appellants,

v.

J.C. BRADFORD & CO.,

Defendant-Appellee.

Glenn T. SANDERS on behalf of himself and all others similarly situated, and Leslie D. Sanders,

Plaintiffs-Appellants,

v.

ROBINSON HUMPHREY/AMERICAN EXPRESS, INC., and Shearson/American Express, Inc.,

Defendants-Appellees.

Tommy E. PARKER, as custodian for Kimberly M. PARKER and James L. Smith, on behalf of themselves and all others similarly situated,

Plaintiffs-Appellants,

v.

PAINE WEBBER GROUP, INC.,

Defendant-Appellee.

Nos. 86-8624 to 86-8626.

United States Court of Appeals,
Eleventh Circuit.

Sept. 15, 1987.

Appeals from the United States District Court for the Northern District of Georgia.

Before VANCE and KRAVITCH, Circuit Judges, and BROWN*, Senior Circuit Judge.

KRAVITCH, Circuit Judge:

Plaintiffs in these companion cases filed certified interlocutory appeals pursuant to 28 U.S.C. § 1292(b) challenging the district court's denial of class certification under Rule 23 of the Federal Rules of Civil Procedure. The district court denied class certification in each case on the alternative grounds that the named plaintiffs were not adequate class representatives as required by Fed.R.Civ.P. 23(a)(4) and that individual questions of fact predominated over common questions of law and fact in contravention of Fed.R.Civ.P. 23(b)(3). Concluding that the district court applied erroneous legal standards, we reverse and remand for further consideration.

I. BACKGROUND

These are a few of the many cases arising out of the virtual collapse in 1984 of the Petro-Lewis oil and natural gas investment funds. From 1970 to 1984, about 180,000 people purchased more than $3 billion worth of Petro-Lewis securities and limited partnerships. When the price of oil and gas declined in 1981 and 1982, Petro-Lewis began borrowing funds to pay partnership distributions, to service its debt, and to promote the sale of additional programs. In February 1984, revealing for the first time that it was in dire financial straits, Petro-Lewis announced that it would implement a series of drastic economy measures, including cutting partnership distributions by as much as 50 per cent and selling between one quarter and one third of its reserves. Numerous lawsuits followed.

In *In re Petro-Lewis Securities Litigation*, [1984-85 Transfer Binder], Fed.Sec.L.Rep. ¶ 91,899 (D.Colo.1984), the U.S. District Court for the district of Colorado approved a settlement of eleven

* Honorable John R. Brown, Senior U.S. Circuit Judge for the Fifth Circuit, sitting by designation.

consolidated class suits brought under various provisions of the federal securities laws against the directors and certain corporate entities of the Petro-Lewis organization. Under the terms of the settlement, the participating class members agreed to release the defendants and all Petro-Lewis subsidiaries in return for the formation of a royalty trust and a settlement fund valued at $23.5 million. The settlement agreement expressly provided that the plaintiff class members retained the right to file suit against any nondefendants, including broker-dealers of Petro-Lewis securities and limited partnerships.

In these cases, plaintiffs allege that the actions of the defendant brokerage firms and individuals in selling and promoting interests in Petro-Lewis violated sections 11 and 12(2) of the Securities Act of 1933, 15 U.S.C. §§ 77k, 77*l*(2), section 10 of the Securities Exchange Act of 1934, 15 U.S.C. § 78j, Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5, and various common law and statutory obligations under state law.[1] Claiming to represent classes of plaintiffs who, between January 1, 1981 to February 6, 1984, purchased, reinvested in, or otherwise acquired Petro-Lewis limited partnership interests from the defendant firms, the plaintiffs alleged that the defendants knowingly or recklessly participated with Petro-Lewis in disseminating materially misleading information regarding Petro-Lewis' financial condition and failed to provide other information that would have made the statements not misleading.

After discovery and hearings, the district court issued an order and an amended order denying certification of the classes under Rule 23 of the Federal Rules of Civil Procedure. Although the court determined that each suit satisfied the class action prerequisites of Fed.R. 23(a)(1), (2), and (3), the court denied certification on the ground that the named plaintiffs were not adequate class representatives as required by Rule 23(a)(4). The basis for this determination was that the named plaintiffs did not

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[1] Additional claims were asserted in some of the complaints. The district court's ruling on these other claims were not challenged on appeal. Accordingly, the district court's denial of class certification as to those claims will not be disturbed.

demonstrate that they would pursue the litigation with sufficient vigor to protect the interests of the class. As an alternative ground of decision, the court held that individual questions of law and fact outweighed common questions and thus that the actions did not satisfy the standards of Rule 23(b)(3). Concluding that its ruling was based upon determinations of law as to which there may be substantial ground for difference of opinion and that an immediate appeal from the denial of class certification would materially advance the ultimate determination of the actions, the court certified its order for an interlocutory appeal pursuant to 28 U.S.C. § 1292(b). We accepted jurisdiction. *See id.*

II. RULE 23(b)(3): PREDOMINANCE OF COMMON OR INDIVIDUAL QUESTIONS

The district court's conclusion that individual questions predominate over common questions is based directly on the court's interpretation of the substance of the plaintiffs' claims. Consequently, we will consider first that aspect of the court's denial of class certification.

In holding that certification was improper under Rule 23(b)(3),[2] the court concluded that common questions of law and fact in the 10(b) and 10b-5 claims were dominated by individual questions of reliance on the part of the particular

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[2] A suit may be maintained as a class action only if the four prerequisites of Rule 23(a) are satisfied and, in addition, the case satisfies one of the requirements of Rule 23(b). *See* Fed.R.Civ.P. 23(b). In this case, there is no dispute that subsections (1) and (2) of Rule 23(b) do not apply. Rule 23(b)(3) permits class action treatment if:

> (3) the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. The matters pertinent to the findings include: (A) the interest of members of the class in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; (D) the difficulties likely to be encountered in the management of a class action.

purchasers, statutes of limitations in each state in which there may be class members, and arbitration agreements in many of the purchase contracts. The court viewed the state law claims to be inappropriate for class action treatment because liability would depend upon the substantive law of the different states. Finally, the court refused to consider certifying classes limited to the section 11 and 12(2) claims after concluding that the 10(b) and state law claims were the dominant claims asserted in the complaints.

A. *Section 10(b) and Rule 10b-5*

The complaints allege that the defendants violated section 10(b) and Rule 10b-5 by engaging in two related but different courses of conduct. First, the complaints contend that the defendants participated with Petro-Lewis in disseminating misleading prospectuses and in engaging in a standardized promotion by the individual brokers. Second, the plaintiffs claim that the firms continued to sell and promote Petro-Lewis shares despite the firms' awareness or reckless disregard of Petro-Lewis' severe financial difficulties. Based on these allegations, the plaintiffs assert three theories of liability under which common issues of law and fact necessarily would outweigh individual issues. They first contend that their claims concern primarily acts of omission and thus that reliance on the part of individual purchasers should be presumed under the rule of *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 92 S.Ct. 1456, 31 L.Ed.2d 741 (1975). Second, they argue that the claims fall under the fraud-on-the-market theory adopted by our predecessor court in *Shores v. Sklar*, 647 F.2d 462 (5th Cir. May 1981) (en banc), *cert. denied*, 459 U.S. 1102, 103 S.Ct. 722, 74 L.Ed.2d 949 (1983).[3] Finally, they argue that the allegations involve a common course of conduct toward all defendants, and thus that any issues of individual reliance could not predominate over common questions of facts. *See e.g., Kennedy v. Tallant*, 710 F.2d 711 (11th Cir. 1983).

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[3] The Eleventh Circuit, in the en banc decision *Bonner v. City of Prichard*, 661 F.2d 1206, 1209 (11th Cir.1981), adopted as precedent decisions of the former Fifth Circuit rendered prior to October 1, 1981.

The district court rejected each of these theories. The court found the characterization of the claims as involving primarily omissions to be precluded by the interpretation in *Huddleston v. Herman & McLean*, 640 F.2d 534 (5th Cir. Unit A March 1981), *aff'd in part and rev'd in part on other grounds*, 459 U.S. 375, 103 S.Ct. 683, 74 L.Ed.2d 548 (1983), and *Cavalier Carpets v. Caylor*, 746 F.2d 749 (11th Cir.1984), of the requirements for an omissions case under *Affiliated Ute*. The court rejected the fraud-on-the-market theory as insufficiently supported by the pleadings or the evidence proffered by the plaintiffs. Finally, the court refused class action treatment under the course of conduct theory based on the court's determination that the plaintiffs' allegations involve primarily individualized oral representations rather than a common scheme by the defendants toward the plaintiff purchasers.

We agree with the district court that under the precedent of this circuit the plaintiffs' complaints cannot be properly characterized as omissions cases under the standards of *Affiliated Ute*. Here, as in *Cavalier Carpets*, *supra*, and *Huddleston*, *supra*, the complaints indicate that "[t]he defendants did not stand mute in the face of a duty to disclose as did the defendants in *Affiliated Ute*." *Cavalier Carpet*, 746 F.2d at 749 n. 22 (*quoting Huddleston*, 640 F.2d at 548). Rather, as in those cases, the allegations contend that the defendants "undertook . . . to disclose relevant information . . . now alleged to contain certain misstatements of fact and to fail to contain other facts necessary to make the statements made, in light of the circumstances, not misleading." *Id.* Consequently, the district court properly concluded that the complaints at most allege mixed claims of misrepresentations and omissions and thus that *Affiliated Ute*'s presumption of reliance does not apply.

We cannot agree, however, with the court's rejection of the fraud-on-the-market theory as a basis for class action treatment. In *Shores v. Sklar*, *supra*, the former Fifth Circuit sitting en banc held that, in fraud claims asserted under Rules 10b-5(1) and (3), the reliance element of Rule 10b-5 may be satisfied by proof that the plaintiff relied on the integrity of the market rather than on specific misrepresentations by the defendants. Under *Shores*,

reliance may be established by proof that securities not traded on the open market could not have been issued but for a fraudulent scheme by the defendants. 647 F.2d at 469; *cf. Lipton v. Documation, Inc.*, 734 F.2d 740, 747 (11th Cir.1984), *cert. denied*, 469 U.S. 1132, 105 S.Ct. 814, 83 L.Ed.2d 807 (1985) (adopting fraud-on-the-market theory in context of securities traded in open market). Here, consistent with *Shores*, plaintiffs alleged that the Petro-Lewis shares, which were not traded on the open market, could not have been marketed but for the defendants' fraud.

In rejecting this claim as improper for class treatment, the court relied solely on its conclusion that the plaintiffs' allegations lacked evidentiary support. Despite the court's assertions to the contrary, this determination was an inappropriate inquiry into the merits of the plaintiffs' claims. Certainly, as the court noted in its order, a court may look beyond the allegations of the complaint in determining whether a motion for class certification should be granted. *General Telephone Co. of Southwest v. Falcon*, 457 U.S. 147, 160, 102 S.Ct. 2364, 2372, 72 L.Ed.2d 740 (1982); *Love v. Turlington*, 733 F.2d 1562, 1564 (11th Cir.1984). Indeed, it is often necessary for a district court to consider, for example, a deposition of a named plaintiff to determine whether Rule 23(a)'s commonality and typicality requirements are met. *See, e.g., Falcon, supra; Nelson v. U.S. Steel Corp.*, 709 F.2d 675, 679-80 (11th Cir.1983). Here, however, the court's rejection of the fraud-on-the-market theory was based upon nothing other than the court's assessment of the plaintiffs' likelihood of success on the claims. This is an improper basis for deciding the propriety of a class action. *E.g., Eisen v. Carlisle & Jacquelin*, 417 U.S. 156, 177-78, 94 S.Ct. 2140, 2152-53, 40 L.Ed.2d 732 (1974); *Nelson*, 709 F.2d at 679.

Nor can the court's rejection of the fraud-on-the-market theory be upheld under the rationale that fraud-on-the-market claims are improper for class treatment where, as here, the evidence indicates that the named plaintiffs relied on the advice of their brokers rather than solely on the integrity of the market. As the defendants note, several district courts have denied class certification for fraud-on-the-market claims where

evidence indicates that the named plaintiffs may in fact have relied on factors other than the market's integrity. These cases, however, generally have concerned fraud-on-the-market claims involving securities traded in an open market. *See Masri v. Wakefield*, 106 F.R.D. 322, 325 (D.Colo.1984); *Seiler v. E.F. Hutton & Co.*, 102 F.R.D. 880, 890 (D.N.J.1984); *McNichols v. Loeb Rhoades*, 97 F.R.D. 331, 334 (N.D.Ill.1982). *But see Shores v. Sklar*, [current] Fed.Sec.L.Rep. (CCH) ¶ 92,874 (N.D.Ala. July 30, 1986) (on remand, denying class certification of fraud-on-the-market claim involving security not openly traded). That version of the fraud-on-the-market theory focuses on the plaintiffs' reliance on the integrity of an open and developed market to set a price accurately reflecting the security's value. *See Lipton v. Documation*, 734 F.2d at 743. The issue of reliance on an open market thus turns on a matter of degree--the price of the security--and not, as in *Shores*, the absolute question of whether the security was worthy of being issued.

Because the Petro-Lewis shares were not traded on the open market, we need not now consider the appropriateness of class certification of traditional fraud-on-the-market claims involving securities that are openly traded. We conclude, however, that where as here, a complaint alleges that a security not traded on the open market could not have been issued but for the fraud of the defendants, class action treatment is not precluded by the possibility that some purchasers, including the named plaintiffs, might have relied on factors other than the integrity of the market.

Shores did not hold, as the defendants contend, that recovery is possible under a fraud-on-the-market claim only when a claimant proves reliance on the integrity of the market to the exclusion of all other factors. Rather, *Shores* was based on the premise that "[t]he securities laws allow an investor to rely on the integrity of the market to the extent that the securities it offers to him for purchase are entitled to be in the marketplace." 647 F.2d at 471. Consequently, where a security could not have been issued but for a fraudulent scheme, the fact that the investor may have relied on other factors in deciding to purchase that security at a particular price does not minimize the essential fact that the purchaser relied on the market's integrity to

ensure that the security was worthy of being issued. Indeed, as the court noted in *Shores*, under a theory that the defendants' fraud caused securities to be issued, "it would have availed [the plaintiff] nothing to have read the [allegedly misleading] Offering Circular." *Id.* at 470-71. A *Shores* fraud-on-the-market claim thus is especially suited for class action treatment, as it makes virtually irrelevant the possibility that the various purchasers may have relied on different representations regarding the desirability of the particular security in question: all have relied on the integrity of the market in the but-for sense required by *Shores*.*

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* In remanding to the district court, *Shores* instructed the court to "reconsider the maintainability of this action as a class action as to members of a properly defined class of Bond purchasers who did not . . . rely [on the allegedly misrepresentative offering circular]." 647 F.2d at 472. This instruction should not be misconstrued as an indication that the fraud-on-the-market claim would be available only to those individuals who did not rely on the circular. The district court previously had determined that a Rule 10b-5(2) misrepresentation claim could be brought as a class action on behalf of a class of purchasers who had relied on the offering circular. The court of appeals recognized that any member of a class so defined necessarily would satisfy one of the elements of a 10b-5(2) claim and thus could recover if it were proven on a class-wide basis that the defendants knowingly made materially misleading statements in the offering circular and that the purchasers suffered losses as a result. *See* 647 F.2d at 468 (listing elements of 10b-5(2) misrepresentation claim). The court realized that, under the facts alleged in that case, these class-wide 10b-5(2) issues would be contained in the proof necessary for recovery under the 10b-5(1) and (3) fraud-on-the-market theory. *See* 647 F.2d at 468 ("[T]he Offering Circular was assertedly only one step in the course of an elaborate scheme."). Those purchasers who did not rely could recover, however, only by meeting the additional burden of proving, under the fraud-on-the-market theory, that the securities could not have been issued but for the fraud of the defendants. Thus, the instruction that the district court determine the maintainability of a separate class for purchasers who did not rely was based simply upon the recognition that, as a practical matter, those purchasers would have a greater factual burden to establish liability than would those who relied on the offering circular. The instruction did not imply, however, that those who had relied on the offering circular could not also recover under the fraud-on-the-market theory. To the extent that the district court on remand reached a different conclusion, *see Shores v. Sklar*, [current] Fed.Sec.L.Rep. (CCH) ¶ 92,074 (N.D.Ala. July 30, 1986), we reject that court's interpretation of the en banc decision.

We conclude for similar reasons that the district court also improperly found that the plaintiffs' 10b-5(2) misrepresentation claims were not suited for class treatment. The basis for the court's denial of class certification of the misrepresentation claims was the court's conclusion that the claims involved primarily oral representations and thus would present individual issues of reliance. To arrive at this conclusion, the court focused on deposition evidence indicating that the named plaintiffs relied not so much on prospectuses and other written materials as on the recommendations of their individual brokers. The court further found that the plaintiffs had uncovered no evidence to show that their particular brokers had attended the Petro-Lewis sales sessions or explicitly followed the standardized sales pitch.

Contrary to the court's construction of the claims, however, the complaints alleged that the defendant brokerage firms and individual officers engaged in a common course of conduct to misrepresent, by affirmative acts and by omission, the financial condition of Petro-Lewis. *See, e.g., Kennedy v. Tallant*, 710 F.2d at 711. Neither the complaints nor the deposition testimony relied upon by the district court indicate that any oral representations to the named plaintiffs varied materially from the misleading information alleged to have been disseminated generally as a result of the defendants' common schemes. *See id.; cf. Simon v. Merrill Lynch, Pierce, Fennner and Smith, Inc.*, 482 F.2d 880, 883 (5th Cir.1973) ("If there is any material variation in the representations made or in the degrees of reliance thereupon, a fraud case may be unsuited for treatment as a class action."). Consequently, the possibility that the named plaintiffs or other potential class members may have obtained the allegedly misleading information via their individual brokers rather than through widely distributed written information cannot transform the allegations of the complaints into claims concerning primarily questions of individual reliance. The claims essentially involve allegations that the defendants "committed the same unlawful acts in the same method against the entire class." *Kennedy v. Tallant*, 710 F.2d at 717.

As in any 10b-5(2) misrepresentation claim, each potential class member must prove reliance on some form of the allegedly

misleading information in order to recover. *See, e.g., Shores v. Sklar*, 647 F.2d at 468. In view of the overwhelming number of common factual and legal issues presented by plaintiffs' misrepresentation claims, however, the mere presence of the factual issue of individual reliance could not render the claims unsuitable for class treatment. Here, as in *Kennedy v. Tallant*, each of the complaints alleges "a single conspiracy and fraudulent scheme against a large number of individuals" and thus is "particularly appropriate for class action." 710 F.2d at 718. Moreover, given the numerous and substantial common issues presented by both the fraud-on-the-market and the misrepresentation claims, the common questions in these cases cannot legitimately be considered subordinate to the individual questions presented by the different state statutes of limitations that may be applicable or by the arbitration agreements contained in some of the purchasers' contracts.[5] "Rule 23 does not require that all the questions of law and fact raised by the dispute be common." *Cox v. American Cast Iron Pipe Co.*, 784 F.2d 1546, 1557 (11th Cir.), *cert. denied*, __U.S.__, 107 S.Ct. 274, 93 L.Ed.2d 250 (1986).

In sum, we conclude that as a result of the district court's erroneous analysis of the fraud-on-the-market claims and its mischaracterization of the misrepresentations claims, the court incorrectly determined that individual issues predominated over common issues. Contrary to the court's conclusions, these claims involve common issues that clearly overwhelm the individual issues that may be present. Consequently, "[s]eparate actions by each of the class members would be repetitive, wasteful, and an extraordinary burden on the courts." *Kennedy v. Tallant*, 710

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[5] The presence of arbitration agreements is relevant for another factor in determining the suitability of class treatment on the 10b-5 claims. After the district court's order was issued, the Supreme Court in *Shearson/American Express v. McMahon*, __U.S.__, 107 S.Ct. 2332, 96 L.Ed.2d 185 (1987), upheld the enforceability of agreements requiring the arbitration of 10b-5 claims. Those purchasers whose 10b-5 claims are subject to arbitration thus could not be considered members of the class. In ruling on the motion for class certification, the district court did not determine whether the potential class members not subject to arbitration would be sufficient to satisfy the numerosity requirement of Rule 23(a)(2). The court should make this determination on remand.

F.2d at 718. The district court thus abused its discretion in ruling that the requirements of Rule 23(b)(3) were not satisfied in this case. *See, e.g., Cox v. American Cast Iron Pipe Co.*, 784 F.2d at 1557-58.

B. *State Law Claims*

In concluding that the state law claims failed to satisfy the requirements of Rule 23(b)(3), the district court reasoned that the differing standards of liability required by the laws of the various states would render class action treatment unmanageable. We agree with the district court that the state law claims would require application of the standards of liability of the state in which each purchase was transacted.[6] The district court thus did not abuse its discretion in denying class certification on these claims. *See, e.g., Simon v. Merrill Lynch, Pierce, Fenner and Smith, Inc.*, 482 F.2d at 883.

C. *Section 11 and 12(2) Claims*

In explaining its denial of class certification of the section 11 and 12(2) claims, the district court stated that it "did not

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[6] Under the Georgia law applicable to these diversity claims, *see Klaxon Co. v. Stentor Electric Mfg. Co.*, 313 U.S. 487, 61 S.Ct. 1020, 85 L.Ed. 1477 (1941), the standard of liability would be determined, as an initial matter, by the law of the state in which the purchaser acquired the security, not of the state from which the shares were sold. *See Risdon Enterprises, Inc. v. Coleman Enterprises, Inc.*, 172 Ga. App. 902, 324 S.E.2d 738, 740 (1984) (explaining Georgia's *lex loci delecti* choice of law rule in tort cases); *see also Zandman v. Joseph*, 102 F.R.D. 924, 930 (N.D.Ind.1984) (Indiana's *lex loci delecti* rule "would require use of the law of the state where each class member suffered his or her pecuniary loss"). If a particular state does not have a controlling statute, however, the Georgia choice of law rule requires application of the common law as construed by the courts of Georgia. *See Frank Briscoe, Inc. v. Georgia Sprinkler Co., Inc.*, 713 F.2d 1500, 1503 (11th Cir.1983); *Risdon Enterprises*, 324 S.E.2d at 741 (1984). Thus, although the law of Georgia might eventually be applied on some claims involving purchases made in other states, that could be determined only after the district court had fully surveyed the law of the states of purchase. Moreover, even if Georgia law would require application of its own common law rules to some claims involving purchases in other states, the law of Georgia could be applied consistent with due process only if the particular transaction had some significant relation to Georgia. *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 105 S.Ct. 2965, 2980, 86 L.Ed.2d 628 (1985).

address" these claims individually because to separate these claims from the Rule 10b-5 and state law claims would be "unduly burdensome" on the court. The court consequently denied class certification of the Rule 11 and 12(2) claims based upon its conclusion that the 10b-5 and the state law claims did not meet the requirements of Rule 23(b)(3). In view of our determination that the court erroneously ruled that 10b-5 claims did not meet the requirements of Rule 23(b)(3), the court must of course reconsider its decision regarding the Section 11 and 12(2) claims.

Independent of our decision on the 10b-5 claims, however, we conclude that the court erred in failing to consider separately the appropriateness of the class action treatment of the section 11 and 12(2) claims. Although there is some overlap between section 10(b) and sections 11 and 12(2), the provisions "involve distinct causes of action and were intended to address different types of wrongdoing." *Herman & McLean v. Huddleston*, 459 U.S. 375, 103 S.Ct. 683, 687, 688, 74 L.Ed.2d 548 (1983). The failure of the district court to give separate consideration to class action certification of these distinct claims thus could serve neither the securities laws' purpose of protecting investors, *see, e.g., id.*, 103 S.Ct. at 687, nor Rule 23's purpose of protecting the courts from needlessly repetitious litigation, *see, e.g., Kennedy v. Tallant*, 710 F.2d at 718. By failing to consider these claims separately, the court abused its discretion.

III. ADEQUATE CLASS REPRESENTATION

Having concluded that the district court's ruling on the requirements of Rule 23(b)(3) constituted an abuse of the court's discretion, we must address the court's alternative holding that the named plaintiffs in each of these cases did not satisfy the adequate representation requirement of Rule 23(a)(4) because they failed to demonstrate sufficient "vigor" to prosecute a class suit.

Among the prerequisites to the maintenance of a class action is the requirement of Rule 23(a)(4) that the class representatives

"will fairly and adequately protect the interests of the class." The purpose of this requirement, as of many other of Rule 23's procedural mandates, is to protect the legal rights of absent class members. Because all members of the class are bound by the res judicata effect of the judgment, a principal factor in determining the appropriateness of class certification is "the forthrightness and vigor with which the representative party can be expected to assert and defend the interests of the members of the class." *Mersay v. First Republic Corp.*, 43 F.R.D. 465, 470 (S.D.N.Y.1968); *see also Shatzman v. Talley*, 91 F.R.D. 270, 273 (N.D.Ga.1981) (insufficiency of funds to prosecute suit indicates the "vigor with which the case will be pursued"); *Dolgow v. Anderson*, 43 F.R.D. 472, 494 (E.D.N.Y.1968) (court "must be assured that 'the representatives [will] put up a real fight' " (*quoting* J. Chafee, Some Problems in Equity 231 (1950)), *rev'd on other grounds*, 438 F.2d 825 (2d Cir.1971); *cf. Falcon*, 457 U.S. at 161, 102 S.Ct. at 2372.

The inquiry into whether named plaintiffs will represent the potential class with sufficient vigor to satisfy the adequacy requirement of Rule 23(a)(4) most often has been described to "involve[ ] questions of whether plaintiffs' counsel are qualified, experienced, and generally able to conduct the proposed litigation and of whether plaintiffs have interests antagonistic to those of the rest of the class." *Griffin v. Carlin*, 755 F.2d 1516, 1532 (11th Cir.1985). Even where these two requirements are satisfied, however, named plaintiffs might not qualify as adequate class representatives because they do not possess the personal characteristics and integrity necessary to fulfill the fiduciary role of class representative. *See, e.g., Kline v. Wolf*, 702 F.2d 400, 402-03 (2d Cir.1983); *Armour v. City of Anniston*, 89 F.R.D. 331, 332 (D.C.Ala.1980), *aff'd*, 654 F.2d 382 (5th Cir. Unit B Aug. 1981); 7A C. Wright, A. Miller and M. Kane, Federal Practice and Procedure, Civil 2d § 1766 at pp. 308-10.

For similar reasons, some courts have found, as did the district court here, that Rule 23(a)(4) was not satisfied where the named plaintiffs demonstrated insufficient participation in and awareness of the litigation. *See, e.g., Darvin v. International Harvester Co.*, 610 F. Supp. 255, 257 (S.D.N.Y.1985);

Massengill v. Board of Educ., 88 F.R.D. 181 (N.D.Ill.1980). In following the lead of these cases, however, the district court appears to have applied a standard that does not vindicate the policies and purposes of Rule 23. Contrary to the district court's approach to the issue, adequate class representation generally does not require that the named plaintiffs demonstrate to any particular degree that individually they will pursue with vigor the legal claims of the class. Although the interests of the plaintiff class certainly would be better served if the named plaintiffs fully participate in the litigation, *see, e.g., In re Goldchip Funding Co.*, 61 F.R.D. 592, 594-95 (M.D.Pa.1974), the economics of the class action suit often are such that counsel have a greater financial incentive for obtaining a successful resolution of a class suit than do the individual class members. *See Deposit Guaranty Nat. Bank v. Roper*, 445 U.S. 326, 338-39, 100 S.Ct. 1166, 1174, 63 L.Ed.2d 427 (1980) (plurality opinion). It is not surprising, then, that the subjective desire to vigorously prosecute a class action, which the district court here found missing in the named plaintiffs, quite often is supplied more by counsel than by the class members themselves. Obviously this creates a potential for abuse. *See id.* at 339, 100 S.Ct. at 1174. Yet the financial incentives offered by the class suit serve both the public interests in the private enforcement of various regulatory schemes, particularly those governing the securities markets, and the private interests of the class members in obtaining redress of legal grievances that might not feasibly be remedied "within the framework of a multiplicity of small individual suits for damages." *Id.*

As the district court aptly noted, a potential class is entitled to "more than blind reliance upon even competent counsel by uninterested and inexperienced representatives." *In re Goldchip Funding Co.*, 61 F.R.D. at 594. For where the named plaintiffs "have abdicated their role in the case beyond that of furnishing their names as plaintiffs," the attorneys, in essence, are the class representative. *Helfand v. Cenco*, 80 F.R.D. 1, 7-8 (N.D.Ill.1977). Several district courts thus have properly denied class certification where the class representatives had so little knowledge of and involvement in the class action that they would be unable

or unwilling to protect the interests of the class against the possibly competing interests of the attorneys. *See, e.g. Efros v. Nationwide Corp.*, 98 F.R.D. 703, 707 (S.D.Ohio 1983); *Helfand v. Cenco, supra; see also* 7A Wright, Miller & Kane at § 1766 pp. 310-11 (the "inquiry into the knowledge of the representative is to ensure that the party is not simply lending his name to a suit controlled entirely by the class attorney.")

In concluding that the named plaintiffs in these cases do not satisfy the adequate representation requirement of Rule 23(a)(4), the district court noted that neither this court nor the Supreme Court has set forth standards for determining the adequacy of class representatives.[7] Because the issue of adequate class representation arises in a wide variety of contexts, it would be inappropriate for us to establish a standard for general application. We conclude, however, that in securities cases such as these, where the class is represented by competent and zealous counsel, class certification should not be denied simply because of a perceived lack of subjective interest on the part of the named plaintiffs unless their participation is so minimal that they virtually have abdicated to their attorneys the conduct of the case. To require less would permit attorneys essentially to serve as class

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[7] In support of its conclusion that the named plaintiffs in these cases are inadequate class representatives, the court cited *Rothenberg v. Security Management Co., Inc.*, 667 F.2d 958 (11th Cir. 1982). *Rothenberg* upheld the dismissal of a Rule 23.1 derivative shareholders' action where the named plaintiff had been found not to be an adequate representative of the other shareholders. In making this determination, the district court and the panel on appeal relied on factors similar to those relied upon by the district court here. *Rothenberg*, however, is not entirely apposite to the determination of adequacy of a class representative under Rule 23(a)(4). A derivative suit poses inherent conflicts between those minority shareholders who are bringing the suit and the majority shareholders whose administration is being challenged either directly or indirectly. *See 7C C. Wright, A. Miller & M. Kane, Federal Practice and Procedure* § 1833 at pp. 137-39. In contrast, a class suit by definition serves to benefit the members of the class. Consequently, a different degree of participation might well be required of a named plaintiff in a Rule 23.1 derivative than of a named plaintiff in a Rule 23 class action. The case before us does not involve a Rule 23.1 certification, and we express no opinion as to what the standard for such cases should be.

representatives; to require more could well prevent the vindication of the legal rights of the absent class members under the guise of protecting those rights.

Although we conclude that the district court applied an erroneous standard in determining that the named plaintiffs would not be adequate class representatives, it would be inappropriate for us to make an independent application of the correct standard in this case. In contrast to the more strictly legal questions presented by the district court's characterization of the plaintiffs' claims in its rulings on the Rule 23(b)(3), the adequacy of class representation is primarily a factual issue that is best left for determination by the district court. Consequently, we remand the Rule 23(a)(4) issue for the district court to apply the standard we have set forth above.

IV. CONCLUSION

For the foregoing reasons, the order of the district court is REVERSED IN PART, AFFIRMED IN PART, and REMANDED with instructions.

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

GLENN T. SANDERS, on behalf of himself and all others similarly situated,

Plaintiffs,

vs.

ROBINSON HUMPHREY/AMERICAN EXPRESS, INC., *et al.*,

Defendants.

CIVIL ACTION No. C 85-172 A

TOMMY E. PARKER, as custodian for KIMBERLY M. PARKER, and JAMES L. SMITH, on behalf of themselves and others similarly situated,

Plaintiffs,

vs.

PAINE WEBBER GROUP, INC.,

Defendant.

CIVIL ACTION No. C 85-1586 A

SUZANNE KIRKPATRICK, DOROTHY D. CASLER, and CHARLES H. LINDSEY,

Plaintiffs,

vs.

J.C. BRADFORD & CO.,

Defendants.

CIVIL ACTION No. C 85-1891 A

July 8, 1986

OPINION OF VINING, DISTRICT JUDGE

ORDER

In these federal securities actions, three motions are now before the court. The facts of these cases are set forth in this court's recent order, filed on March 28, 1986 ("the previous order"). The first motion is the plaintiffs' motion to reconsider the previous order, which denied their motion for class certification under Rule 23, Federal Rules of Civil Procedure. Second, the plaintiffs have asked this court to amend the previous order to certify it for interlocutory appeal, pursuant to Rule 5 of the Federal Rules of Appellate Procedure and 28 U.S.C. § 1292(b). Last, the plaintiffs have moved for an order staying the previous order until the date when the Eleventh Circuit Court of Appeals rules on the plaintiffs' interlocutory appeal. The court addresses each of these motions in turn.

I. MOTION FOR RECONSIDERATION

The court's denial of class certification in each of these cases was based upon an extensive review of the record presented to the court through pleadings, discovery, and oral hearings. Five areas of concern required that the court deny class certification to the named plaintiffs. These areas of concern and the reasoning behind the court's treatment of each area are set out in complete detail in the previous order. The first of these is that the plaintiff cannot adequately represent the class as a whole as required by Rule 23(a)(4), Federal Rules of Civil Procedure. The remaining four bases for denial of class certification address the requirements of Rule 23(b)(3), that common questions of law and fact do not predominate over individual issues. These individual issues involve the requirement of proof of reliance as an element in actions under section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5 promulgated under that Act; the fact that arbitration agreements signed by potential class members provide for a better, more efficient method of adjudicating the claims by many of the potential class participants; and the fact that many potential class members are from various states throughout the country, thus requiring application of their individual state statutes of limitations as well as the need to apply the law of each state in which potential class members reside.

The plaintiffs disagree with the court's finding in each of these areas and have requested the court to reconsider the class certification based upon these findings as well as the court's failure to address Counts I and II, brought pursuant to sections 11 and 12(2) of the Securities Act of 1933, 15 U.S.C. §§ 77k, 77*l*(2). Each of these areas addressed by the plaintiffs will be discussed seriatim below. However, the court at this juncture believes it necessary to inform the plaintiffs of its method of handling the class certification issue.

First, the plaintiffs request that the court consider each individual issue, count, or other separate determination as a single issue not tied to any other issue for purposes of class certification. Although some courts have opted to bifurcate class actions, this court finds that to do so in this case would be unduly burdensome and would not be the best method of handling the cases. Therefore, the court has looked at each requirement of Rule 23, then combined its findings on each element of Rule 23 to determine whether class certification is appropriate for each case as a whole. For this reason, the court did not address the counts brought under sections 11 and 12(2) of the Securities Act of 1933. After reviewing the requirements for class certification under section 10(b) and Rule 10b-5 and the state law claims, the court determined that the plaintiffs had not met their burden of proving the elements necessary to meet the class certification requirements for these claims and did not, nor does it now, believe the section 11 and section 12(2) claims needed to be addressed in determining whether the plaintiffs' actions as a whole warrant class certification.

As to the remainder of the issues addressed by the plaintiffs in their motions to reconsider, the court believes that some clarification is necessary. After carefully considering each of the plaintiffs' contentions, the court finds them all without merit.

A. Rule 23(a)(4): Adequacy of Representation

In the previous order, the court held that the plaintiffs failed to satisfy the second requirement of Rule 23(a)(4) because they failed to convince the court that they would vigorously prosecute these class actions. Order at p. 22. First, the plaintiffs did not

attend the hearing. In the motion for reconsideration the plaintiffs contend that they did not appear at the hearing because the court quashed subpoenas seeking to compel their attendance. While the plaintiffs are correct that they were not *required* to attend the hearing, the court views their unwillingness to do so as *one indication* of a lack of interest in these lawsuits. Contrary to the plaintiffs' contentions, their failure to appear at the hearing was not *determinative*. As the court stated in its previous order, the "totality of the circumstances" surrounding this litigation led the court to its decision. *Id.*; *see id.* at 23-26 (setting out the other reasons that the plaintiffs are inadequate representatives).

The plaintiffs also contend that the court placed undue emphasis on their lack of familiarity with the complaint and the case as a whole. This court has stated that "the knowledge and involvement of plaintiff with the suit . . . [are] some of the factors relevant to a determination of a plaintiff's adequacy as a class representative." *Schatzman v. Talley*, 91 F.R.D. 270, 273 (N.D. Ga. 1981). Again, under the totality of the circumstances, the plaintiffs' lack of familiarity with these cases is another indication of their uncertain commitment to these lawsuits. The plaintiffs cite *Surowitz v. Hilton Hotels Corp., 383 U.S. 363, 86 S. Ct. 845 (1966), for the proposition that their lack of familiarity is not a critical issue. Surowitz* is inapposite because it does not address the degree of interest that a plaintiff must display to satisfy Rule 23(a)(4). *Surowitz* dealt with the question of whether a derivative plaintiff must personally investigate the facts underlying the complaint.

In the reply brief in *Parker*, the plaintiffs criticize the defendant for citing deposition testimony indicating that the defendant's broker, as opposed to the defendant, did not conceal the truth about Petro-Lewis. According to the plaintiffs, this lawsuit is against Paine Webber, not its brokers. Plaintiff Parker, however, does not have any reason to believe that either the defendant or its broker defrauded him:

> Q. Do you think that Lee Smith [Parker's broker] intended to deceive you?

A. No.

Q. Do you know of anybody at Paine Webber who intended to deceive you?

A. No, sir, I don't.

Q. Do you have any basis for believing that anybody at Paine Webber intended to deceive you?

A. No, sir, I don't.

Q. Do you believe that Lee Smith was part of a fraud or conspiracy to deceive you?

A. No, sir.

Q. Do you know of anybody at Paine Webber who was part of a fraud or conspiracy to deceive you?

A. No, sir.

Deposition of Tommy E. Parker, pp. 81-82.

Finally, the plaintiffs assert that courts have tolerated wide variances in the named plaintiffs' understanding of and involvement in class action lawsuits. They quote from *Ross v. BankSouth, N.A.*, [1985-86 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92, 526 (N.D. Ala. 1986), which takes a particularly lenient view of the threshold necessary to meet Rule 23(a)(4). Some courts, however, have been much more demanding of class representatives. For example, in *Greenspan v. Brassler*, 78 F.R.D. 130, 133-34 (S.D.N.Y. 1978), the court found that putative class representatives failed to satisfy Rule 23(a)(4) for some of the same reasons mentioned in this court's previous order:

> Although plaintiffs appear willing and able to bear the costs of this litigation, they have demonstrated an alarming unfamiliarity with the suit. They did not meet with their attorney until the basic groundwork

> of the action had been laid. Neither could identify any of the defendants other than NJB. Neither was aware of certain elements of the complaint. Indeed, plaintiffs appear to place undue emphasis on their counsel's ability to conduct the litigation. Plaintiffs' limited personal knowledge of the facts underlying this suit, as well as their apparently superfluous role in this litigation to date, indicate their inadequacy as class representatives. (citations to deposition testimony and cases omitted).

The court also finds that the analysis in *In re Goldchip Funding Co.*, 61 F.R.D. 592, 594 (M.D. Pa. 1974), which is quoted with approval in *Greenspan*, applies in this case:

> The class is entitled to more than blind reliance upon even competent counsel by uninterested and inexperienced representatives. A proper representative can offer more to the prosecution of a class action than mere fulfillment of the procedural requirements of Rule 23. He can, for example, offer his personal knowledge of the factual circumstances, and aid in rendering decisions on practical and non-legal problems which arise during the course of litigation. An attorney who prosecutes a class action with unfettered discretion becomes, in fact, the representative of the class. This is an unacceptable situation because of the possible conflicts of interest involved. (citation omitted).

Neither the Supreme Court nor the Eleventh Circuit has established specific guidelines for district courts to follow in making factual findings under Rule 23(a)(4). Determinations relating to the adequacy of a class representative are factual in nature--their resolution "depends on all the facts and circumstances of a particular case and is entrusted to the discretion of the trial court." *Dudo v. Schaffer*, 93 F.R.D. 524, 531 (E.D. Pa. 1982) (citations omitted); *see Freeman v. Motor Convoy, Inc.*, 700 F.2d 1339, 1347 (11th Cir. 1983). The plaintiffs have failed to point out any new facts or theories that would lead this court to change its holding.

B. Reliance and Fraud on the Market

The issue of reliance is central to a section 10(b) and Rule 10b-5 claim. The plaintiffs allege that the court's consideration of the issue of reliance at this point in the litigation process is an improper intrusion into the merits of the case. Although the court acknowledges that a consideration of the case on its merits is not always appropriate in determining class certification, it is generally accepted law in this circuit that the court may inquire into the merits of the case provided the granting or denial of class certification is not based upon whether the court believes the plaintiff may or may not prevail in its suit. *Huff v. N.D. Cass Co. of Alabama*, 485 F.2d 710 (5th Cir. 1973). Indeed, the Supreme Court has acknowledged the need for investigation into the merits of the case because "actual, not presumed, conformance with Rule 23(a) remains, however, indispensable," *General Telephone Co. of Southwest v. Falcon*, 457 U.S. 147, 160, 102 S. Ct. 2364, 2372, 72 L.Ed.2d 740 (1982),[1] in that "the class determination generally involves considerations that are 'enmeshed in the factual and legal issues comprising the plaintiffs cause of action,' " *Coopers & Lybrand v. Livsey*, 437 U.S. 463, 469, 98 S. Ct. 2454, 2458, 57 L.Ed.2d 351 (1978) quoting *Mercantile National Bank v. Langdeau*, 371 U.S. 555, 558, 83 S. Ct. 520, 522, 9 L.Ed.2d 523 (1963)).

The plaintiffs allege that the presumption of reliance in *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 92 S. Ct. 1456, 31 L.Ed.2d 741 (1972), should be applied to the cases at bar. This

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[1] The court notes that the plaintiffs are likely to assert that the reliance issue falls within Rule 23(b)(3), as discussed by this court, as opposed to Rule 23(a) in *Falcon* and that conformance with Rule 23(b) is not indispensable. However, one of the three sections of Rule 23(b) must be met for class certification purposes. Additionally, many courts have treated the issue of reliance as a typicality or commonality requirement, *e.g.*, *Nelson v. U.S. Steel Corp.*, 709 F.2d 675 (11th Cir. 1983), which treatment would necessarily thwart class action status as plaintiffs would fail to meet the indispensable requirements of Rule 23(a), reliance being an issue to be handled on an individual basis. This court, however, feels that some elements of typicality and commonality are present in each of the class representatives and has chosen to treat the issue of reliance under Rule 23(b).

court has thoroughly dealt with this presumption of reliance in its previous order and will not delve into the matter further. In an attempt to sway this court away from its prior decision denying to the plaintiffs the presumption of reliance based on the fraud on the market theory, the plaintiffs have brought to the court's attention several cases permitting this use of the fraud on the market theory. *See Ross v. BankSouth, N.A.*, Fed. Sec. L. Rep. [1985-86 Transfer Binder] ¶ 92,526 (N.D. Ala. 1986); *Klein v. A.G. Becker Paribas, Inc.*, 83 Civ. 6456 (GLG) (S.D.N.Y. March 19, 1986); *Dekro v. Stern Bros. & Co.*, 540 F. Supp. 406 (W.D. Mo. 1982); *Arthur Young & Co. v. United States District Court*, 549 F.2d 686 (9th Cir. 1977).

The *Klein* case sets forth the elements of a fraud on the market case. The elements necessary to establish a rebuttable presumption of reliance, as set out in *Klein*, are "that (1) an affirmative representation affected the price of a security traded on the open market, (2) the plaintiff relied to his detriment on the integrity of the market price, and (3) the price of the security 'reacted adversely' when the truth was revealed concerning the issuer of the security."

With the exception of *Arthur Young*, the cases cited by the plaintiffs allowing the fraud on the market theory to stand met the first element in *Klein* in that they involved sales of stocks or bonds on the *open market*. *Arthur Young* involved securities not traded on the open market. In fact, the securities were interests in five oil joint ventures similar to the interests sold in the instant cases. In *Arthur Young*, the parties were before the court on a motion by the defendants for a writ of mandamus requiring the district court to set aside its order and strike the class allegations from the complaint. The district court in *Arthur Young* had bifurcated the case allowing some issues to be certified for class action and other issues to be held for individual adjudication. One of the issues to be tried individually was that of reliance or causation. *Arthur Young*, 549 F.2d at 690. Additionally, the misrepresentations and omissions in *Arthur Young* did not involve *oral* misrepresentations. In fact, all claims based upon oral misrepresentations were withdrawn by the plaintiffs from the suit. *Arthur Young*, 549 F.2d at 689, n.5. Also, the court in

Arthur Young considered that case to be one involving only omissions, where reliance can be inferred under the *Ute* decision, rather than an *oral* misrepresentations and omissions case as are the cases at bar. *Arthur Young*, 549 F.2d at 694. The fact that reliance was held to be an individual issue, the fact that oral misrepresentations claims were withdrawn by the plaintiffs because of difficulties inherent in such claims in determining class action status, and the fact that the case was an omissions case are supportive of this court's position denying the class action in the instant cases and cannot be used to support the plaintiffs in their search for a theory on which to base class action status.

The remaining cases cited by the plaintiffs in support of the fraud on the market theory, *viz.*, *Dekro*, *Klein*, and *Ross*, involved securities sold on the open market, differentiating them from the cases at bar, where the securities were not sold on the open market. In *Ross*, the only case cited by the plaintiffs within the jurisdiction of the Eleventh Circuit, the court went to great lengths to outline instances where the fraud on the market presumption of reliance cannot be allowed. That court then, without sufficient factual analysis to support its decision, found the fraud on the market theory viable for purposes of determining reliance. It can only be assumed by this court that Judge Propst first determined the requirement that the securities be traded on the open market had been met before allowing the presumption of reliance under the fraud on the market theory.

Shores v. Sklar, 647 F.2d 462 (5th Cir. 1981), *cert. denied*, 459 U.S. 1102 (1983), obviates the need for trading on the open market if the security would not have been marketed at all but for the fraud. The plaintiffs alleged in their complaints that "but for the false and misleading statements contained in the registration statements and prospectuses and material information omitted therefrom, the Petro-Lewis partnership programs could not have been marketed and sold to plaintiffs and members of the class."[2] The plaintiffs assert that these allegations must be accepted as

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[2] Robinson-Humphrey Amended Complaint, ¶ 55; J.C. Bradford Amended Complaint, ¶ 52; Paine Webber Second Amended Complaint, ¶ 50.

true for purposes of ruling on the class status motion but cite no support for this assertion. The court, however, is not required to look at and accept as true allegations of the complaint for purposes of Rule 23 class certification. *Huff v. N.D. Cass Co. of Alabama*, 485 F.2d 710, 713 (5th Cir. 1973). The plaintiffs' only support for the allegation, that but for the fraud and misleading statements the securities would not have been sold, lies in their reliance upon the suit filed by the Securities and Exchange Commission against Petro-Lewis, *see In re Petro-Lewis Securities Litigation*, [1984-85 Transfer Binder] ¶ 91,899 (D. Colo. 1984), and the assumption that the SEC never would have approved the offerings had the misrepresentations been discovered prior to approval.

First, it should be noted that the SEC does not approve nor disapprove securities for sale; it merely reviews the prospectus for compliance with SEC regulations. The issue then is not whether the SEC would have approved the offerings but whether the securities could have been sold but for the fraud. The reliance upon *In re Petro-Lewis* is misplaced as that case was settled out of court with the opinion of the court being that "in my view, after reviewing the entire matter, there are serious questions of law and fact which place the outcome of this action, if tried rather than settled, in substantial doubt." *In re Petro-Lewis*, ¶ 91,899 at p. 90,470. The support for the allegations that the securities would not have been sold but for the misrepresentations is not present, insofar as this court can determine, in the pleadings and evidence admitted by plaintiffs to the extent necessary to satisfy this court that the allegation has some basis and is not just a shot in the dark attempt to bring the case within the purview of a fraud on the market theory.

In addition to the element requiring sales on the *open market*, a fraud on the market claim under *Klein* requires that a plaintiff *rely* upon the integrity of the market in purchasing the securities. The court is aware of no evidence presented by the plaintiffs supporting this element. Indeed, the only information relied upon by each of the plaintiffs was information supplied

to them orally by their brokers.[3]

In light of the foregoing the court finds that the elements necessary to support a fraud on the market theory which would allow for a rebuttable presumption of reliance in a section 10(b) and Rule 10b-5 action are not present. The court has determined that reliance is paramount to the cases at bar. Due to the nature of these cases as oral misrepresentations cases the reliance must be proven on an individual basis. This requirement is, as stated in the court's previous order, one more obstruction to the granting of class status to these actions.

C. Arbitration

A third issue discussed by the court in its previous order is that of possible arbitration of claims against the defendants. In each of the three cases at bar the defendants have asserted that a number of potential class members have signed arbitration agreements with the defendants for handling of possible claims against them. Some of the defendants have presented no concrete evidence of arbitration agreements with the named plaintiffs. However, because of the general practice of brokerage firms to procure such agreements, the court is satisfied for purposes of class certification that each of the defendants is able to substantiate arbitration claims with some potential class members which could greatly disrupt these proceedings should class certification be granted.

The plaintiffs have referred the court to two recently decided cases concerning arbitration which the court feels compelled to address and distinguish. First, plaintiffs submit that this court should follow the decision in *McMahon v. Shearson/American*

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[3] The plaintiffs in *Paine Webber* have asserted in separate pleadings that they did not rely upon oral misrepresentations of the brokers but in fact relied upon prospectuses presented to them. However, the evidence as presented by the plaintiff and defendants on the issue of reliance and oral versus written misrepresentations is a defense which could be raised against these plaintiffs. Such a defense would be atypical of defenses which could be raised against other plaintiffs in *Paine Webber* and therefore would not allow for the presumption of reliance in *Paine Webber*.

Express, Inc., 788 F.2d 94 (2d Cir. 1986), where Shearson sought to compel arbitration of Rule 10b-5 claims pursuant to arbitration agreements signed by the plaintiffs in that case. In *McMahon*, the Second Circuit, because of the failure of the Supreme Court in *Dean Witter Reynolds, Inc. v. Byrd*, ____ U.S. ____, 105 S. Ct. 1238 (1985) to rule on the arbitrability of 10(b) and 10b-5 claims, ruled that that circuit would not depart from its previous decisions that these claims are not arbitrable. While this court acknowledges the position of the Second Circuit in following the precedents in its circuit, it is not bound by that decision. This court holds that arbitration agreements signed by the plaintiffs and potential class members in the cases at bar are enforceable. *See Schultz v. Robinson-Humphrey/American Express, Inc.*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 92,515 (M.D. Ga. 1986); *Chandler v. Drexel Burnham Lambert, Inc.*, No. C85-1585A (N.D. Ga. Oct. 28, 1985); *Raiford v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, Civ. No. C83-685A (N.D. Ga. May 16, 1985). This holding is based upon the national policy adhered to in *Byrd* of favoring arbitration agreements. *See also Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, ____ U.S. ____, 105 S. Ct. 3346 (1985). That these arbitration agreements may be readily enforceable leads this court to the determination that yet another individual issue predominates over common issues of law and fact. Additionally, these agreements provide what this court perceives to be a better method of adjudicating a large number of claims by potential plaintiffs against the defendants.

In a second attempt to bar the potential use of arbitration clauses by the defendants the plaintiffs draw the court's attention to *Smokey Greenhaw Cotton Co., Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 785 F.2d 1274 (5th Cir. 1986). The plaintiffs cite this case to support the proposition that *Byrd* cannot be applied retroactively. The plaintiffs, however, fail to acknowledge the bold distinction between *Smokey Greenhaw* and the cases at bar. In *Smokey Greenhaw*, the questions to be submitted to arbitration had already been decided by a jury prior to *Byrd*. To apply *Byrd* in that instance would have required arbitration of issues already decided by a competent court of law. The court in fact states,

> Without so deciding, we might be more inclined to direct the parties to the arbitration room had this case been awaiting trial when the *Dean Witter Reynolds* opinion was handed down. However, equity demands that, where the trial has been completed, the proposed judgment rendered, and only the relative ministerial task of approving the form of the judgment remains, Greenhaw should not be denied his victory and forced once again to do battle in a different forum.

Smokey Greenhaw, 785 F.2d at 1279-80. Had the cases at bar been tried on their merits prior to the decision in *Byrd*, this court might well hold that the *Byrd* analysis was not retroactive. However, these cases have not yet even passed the preliminary procedural stages. For these reasons, the court adheres to its position as enunciated in its previous order with respect to the arbitrability issue of these class certifications.

D. Rule 10b-5: Statute of Limitations

In its previous order, this court held that because the statute of limitations is taken from state law, the claims are inappropriate for treatment as class actions. Order at pp. 42-43; *see Elster v. Alexander*, 76 F.R.D. 440, 442 (N.D. Ga. 1977), *appeal dismissed*, 608 F.2d 196 (5th Cir. 1979). In arguing that this court erred, the plaintiffs contend that the general rule in securities class actions involving a national class is that the court should apply a single statute of limitations for Rule 10b-5 claims. *See, e.g., State Teachers Retirement Board v. Fluor Corp.*, 80 F.R.D. 142, 144-45 (S.D.N.Y. 1978); *In re National Student Marketing Litigation* [1981 Transfer Binder], Fed. Sec. L. Rep. (CCH) ¶ 97,926 (D.D.C. 1981). The plaintiffs, however, cite no circuit court authority for this proposition,[4] and they do not attempt to distinguish, or even discuss, *Elster*. Because the court continues to believe that the analysis in *Elster* is correct, this court adheres

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[4] In fact, *In re National Marketing* relies on the reasoning in *State Teachers*. No other federal court has ever followed *State Teachers*.

to its prior holding. The plaintiffs have failed to cite any appellate or Supreme Court authority that dictates another result.

E. State and Common Law Claims

The plaintiffs next argue that this court failed to engage in the analysis mandated by *Phillips Petroleum Co. v. Shutts*, ____ U.S. ____, 105 S. Ct. 2965 (1985), and misapplied the holding in that case.[5] In part III of the *Shutts* opinion, the Supreme Court began by establishing that Kansas contract and equity law differed from Texas and Oklahoma contract and equity law. *See id.* at ____, 105 S. Ct. at 2977-78. Similarly, this court outlined the differences in the elements of a fraud claim in numerous jurisdictions in this country. *See* Order at pp. 49-51. Like the Supreme Court in *Shutts*, this court concluded that, based on the differences in the laws of the various states, it would be unconstitutional for the court to apply Georgia law to transactions in which investors had no contact with Georgia, nor any reasonable expectation that Georgia law would apply to their purchases.[6] *Shutts* holds that a court "may not take a transaction with little or no

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[5] The plaintiffs do not address *Simon v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 482 F.2d 880, 883 (5th Cir. 1973), in which the court held:

> [T]he geographic dispersion of the alleged representations would bring into issue various state common law standards. With no single law governing the entire class, common issues of law cannot be shown to warrant Rule 23 treatment.

That decision is binding on this court. *See Bonner v. City of Prichard*, 661 F.2d 1206, 1209 (11th Cir. 1981) (*en banc*) (adopting the law of the Fifth Circuit prior to October 1, 1981, as binding precedent). In addition, the plaintiffs once again failed to distinguish or even address *Elster v. Alexander*, 76 F.R.D. 440, 442 (N.D. Ga. 1977), *appeal dismissed*, 608 F.2d 196 (5th Cir. 1979). *See* Order at pp. 48-49 (citing decisions that follow the reasoning in *Simon* and *Elster*).

[6] In *Sanders* the defendants' attorney indicates that his examination of client mailing lists taken from the defendants' business files shows that the defendants sold Petro-Lewis limited partnership interests to clients maintaining addresses in 32 states, the District of Columbia, and West Germany. Supplemental Affidavit of Peter J. Anderson, ¶ 3.

relationship to the forum and apply the law of the forum in order to satisfy the procedural requirement that there be a 'common question of law.' " *Shutts*, ____ U.S. at ____, 105 S. Ct. at 2980.

The Supreme Court in *Shutts* also quoted from *Allstate Insurance Co. v. Hague*, 449 U.S. 302, 312-13, 101 S. Ct. 633, 640 (1981), in which it had stated, "For a State's substantive law to be selected in a constitutionally permissible manner, that State must have a significant contact or significant aggregation of contacts, creating state interests, such that choice of its law is neither arbitrary nor fundamentally unfair." In the instant case, the named plaintiffs are residents in this district and the defendants do business here. Based on these facts alone, the court fails to see how Georgia has "a significant contact or significant aggregation of contacts, creating state interests" such that Georgia law should apply to investors from other parts of the country. As the Supreme Court stated, "Given [Georgia's] lack of 'interest' in claims unrelated to that State, and the substantive conflict with jurisdictions such as Texas, we conclude that application of [Georgia] law to every claim in this case is sufficiently arbitrary and unfair as to exceed constitutional limits." *Shutts*, ____ U.S. at ____, 105 S. Ct. at 2980 (footnote omitted).

The plaintiffs contend that this court should adopt the reasoning in *In re Pizza Time Theatre Securities Litigation*, No. C-84-20048 (A), Order Certifying Plaintiff Class (N.D. Cal. March 18, 1986), in which a California district court interpreted *Shutts* to mean that plaintiffs "must demonstrate only that California has a sufficient aggregation of contacts to their *claims* to insure that the application of California law would not be arbitrary or unfair." Slip op. at 4 (emphasis in original). The *Pizza Time* court explained California's interest in applying its own law to the pendent claims in the class action:

> In the instant action, California has a considerably greater aggregate of contacts with plaintiffs' claims than did Kansas in the *Shutts* case. Here, the defendant corporation was incorporated and headquartered in California, all the non-underwriter defendants were California residents, the alleged misrepresentations emanated from California, and many of the plaintiffs

> were California residents. The non-resident underwriter defendants received millions of dollars in fees from the California corporation, and the plaintiffs allege that the underwriter defendants conspired with the California defendants to defraud the plaintiffs. Not only are the contacts evident, but California has a strong interest in the allegedly fraudulent conduct of its corporations and residents, and in protecting its residents and others from such fraud. The application of California law to the pendent claims in this case would not be arbitrary. *Id.* at Slip Op. at 4-5.

In this case, however, Georgia has nowhere near the number of contacts that California had with the plaintiffs' claims in *Pizza Time*: Robinson-Humphrey is the only defendant that is either incorporated or headquartered in Georgia; the alleged misrepresentations emanated from all over the country because the putative class members purchased partnership interests from brokerage houses all over the country; and many of the putative class members are not Georgia residents. While California may have had a sufficient aggregation of contacts to the plaintiffs' claims in *Pizza Time*, that is clearly not the case here. The facts in this action more closely resemble the facts in *Shutts* than *Pizza Time*.

A second reason that this court will not follow *Pizza Time* is that *Shutts* does not overrule the reasoning in *Simon*, 482 F.2d at 883, or *Elster*, 76 F.R.D. at 442. This court will follow these decisions.

Finally, the *Shutts* court held that an important element in deciding whether to certify a class is the expectation of the parties. As in *Shutts*, there is no indication that when the investors purchased the limited partnership interests outside of Georgia they had any idea that Georgia law would control. *Shutts*, ____ U.S. at ____, 105 S. Ct. at 2980.[7]

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[7] Another reason that *Pizza Time* is inapposite is that the California court concluded that "California's aggregate contacts with, and interest in, the events

(footnote continued)

II. INTERLOCUTORY APPEAL

The plaintiffs have asked this court to amend its earlier order to certify it for interlocutory appeal, pursuant to Rule 5, Federal Rules of Appellate Procedure. Rule 5 provides that an order may be amended at any time to include the statement prescribed by 28 U.S.C. § 1292(b). This statute states in part:

> When a district judge, in making in a civil action an order not otherwise appealable under this section, shall be of the opinion that such order involves a controlling question of law as to which there is substantial ground for difference of opinion and that an immediate appeal from the order may materially advance the ultimate termination of the litigation, he shall so state in writing in such order. The Court of Appeals may thereupon, in its discretion, permit an appeal to be taken from such order. . . .

First, the court finds that several controlling questions of law exist about which substantial grounds exist for differences of opinion. While a section 1292(b) review is inappropriate for challenges to a judge's discretionary rulings, *Garner v. Wolfinbarger*, 433 F.2d 117, 120 (5th Cir. 1970), the court finds that the legal issues that it has discussed under Rule 23(b), *see* Order at pp. 27-51, are by no means settled.

As to the issues of reliance and fraud on the market, the Eleventh Circuit has accepted a presumption of reliance based upon a fraud on the market theory, *Lipton v. Documation, Inc.*, 734 F.2d 740 (11th Cir. 1984); *Shores v. Sklar*, 647 F.2d 462 (5th Cir. 1981) (*en banc*), *cert. denied*, 459 U.S. 1102, 103 S. Ct. 722 (1983). However, the fraud on the market presumption of reliance has presented some ambiguities as to its application to securities not sold on the open market; furthermore there is no clear

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alleged in the complaint were self-evident at the time and sufficient to give notice to the parties that California law might apply in any subsequent litigation." *Pizza Time*, Slip op. at 5.

definition of what the "open market" actually is. *See Arthur Young & Co. v. United States District Court*, 549 F.2d 686 (9th Cir. 1977); *Ross v. BankSouth, N.A.*, Fed. Sec. L. Rep. [1985-86 Transfer Binder] ¶ 92,526 (N.D. Ala. 1986). An interlocutory appeal of this court's ruling on this issue is thus warranted by the facts of the case at bar.

In addition, while this court has held that section 10(b) and Rule 10b-5 claims under the Securities Exchange Act of 1934 are arbitrable, *see Raiford v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, C83-685A (N.D. Ga. May 16, 1985); *Chandler v. Drexel Burnham Lambert, Inc.*, C85-1585A (N.D. Ga. Oct. 28, 1985), the Eleventh Circuit, sitting *en banc*, just heard oral argument on this issue. *Wolfe v. E.F. Hutton*, No. 85-3352 (11th Cir.) (*en banc*). District court decisions in this circuit are conflicting. *Compare Ross v. Mathis*, 624 F. Supp. 110 (N.D. Ga. 1986) (holding Rule 10b-5 claims arbitrable) *with GMO V.A. Del Castillo v. Paine Webber, Inc.*, C85-2410A (N.D. Ga. Dec. 12, 1985) (holding Rule 10b-5 claims not arbitrable).

Another reason why this case should be certified for interlocutory appeal is that some courts have held that securities class actions involving a national class require a court to apply a single statute of limitations for Rule 10b-5 claims of the entire class. *See, e.g., State Teachers Retirement Board v. Fluor Corp.*, 80 F.R.D. 142, 144-45 (S.D.N.Y. 1978); *In re National Student Marketing Litigation*, [1981 Transfer Binder], Fed. Sec. L. Rep. (CCH) ¶ 97, 926 (D.D.C. 1981). Although this court disagrees with the holding in those cases, the court does recognize that this is a controlling question of law as to which there is substantial ground for difference of opinion.

Finally, the plaintiffs contend that this court has misinterpreted the holding in *Phillips Petroleum Co. v. Shutts*, ____ U.S. ____, 105 S. Ct. 2965 (1985), and misapplied it to the facts at bar. Again, the court believes its decision is correct but also recognizes that there is substantial ground for difference of opinion.

The court finds that an immediate appeal from its previous order and this order will materially advance the ultimate

termination of this litigation. Resolving the class certification on interlocutory appeal will prevent any duplicative effort by both sides of this litigation if investors individually proceed to bring the same or similar claims against the defendants. An appeal will provide an efficient mechanism for the prompt resolution of many of the issues in this case.

For these reasons, the plaintiffs' motion to amend this court's previous order to certify it for interlocutory appeal is GRANTED, and the court hereby certifies this order for interlocutory appeal also.

III. MOTION TO STAY

The final motion before this court is the plaintiffs' motion for an order staying this court's previous order until the date when the Eleventh Circuit rules on the plaintiffs' interlocutory appeal. The plaintiffs seek to toll the statute of limitations concerning all claims of all putative class members. This motion is made pursuant to 28 U.S.C. § 1292(b), which provides in part: ". . . application for an appeal hereunder shall not stay proceedings in the district court unless the district judge or the Court of Appeals or a judge thereof shall so order."

Under Local Rule 300-4 and this court's previous order, the plaintiffs' attorneys were prevented from communicating with putative class members who contacted them concerning possible lawsuits against the defendants. These potential class members have been deprived of the opportunity to assert their claims during the pendency of the motions for class certification. The combined effect of the Local Rule and this court's order may be to effectively prevent these individuals from pursuing their legal claims. If the court does not stay its previous order, many individuals may unknowingly lose their right to bring certain causes of action. A stay may provide additional protection for putative class members until the Eleventh Circuit determines whether the class action device is available. (This court does not decide whether the stay will, in fact, toll the statute of limitations.)

In addition, many putative members of the class have not been in contact with the plaintiffs' attorneys and may be unaware of

the potential prejudice to their rights that may result from this court's previous order. Many of these individuals may be unaware of the impending limitations deadline. This court recognizes the potential prejudice to putative class members from its previous order and does not want to deny these individuals due process of law or a day in court. Accordingly, the motion to stay is GRANTED.

IV. SUMMARY

The plaintiffs' motion to reconsider this court's order filed on March 28, 1986, denying the plaintiffs' motion for class certification under Rule 23, Federal Rules of Civil Procedure is DENIED. The plaintiffs' motion to amend this court's previous order to certify this case for interlocutory appeal pursuant to Rule 5, Federal Rules of Appellate Procedure and 28 U.S.C. § 1292(b) is GRANTED. The plaintiffs' motion for an order staying its previous order is GRANTED, and proceedings are hereby STAYED until the date on which the Eleventh Circuit denies the plaintiffs' request for an interlocutory appeal or, if granted, the date on which the Eleventh Circuit issues its mandate following the appeal.

SO ORDERED.

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

GLENN T. SANDERS, on behalf of himself and all others similarly situated,

Plaintiffs,

vs.

ROBINSON HUMPHREY/AMERICAN EXPRESS, INC., *et al.*,

Defendants.

CIVIL ACTION No. C 85-172 A

TOMMY E. PARKER, as custodian for KIMBERLY M. PARKER, and JAMES L. SMITH, on behalf of themselves and others similarly situated,

Plaintiffs,

vs.

PAINE WEBBER GROUP, INC.,

Defendant.

CIVIL ACTION No. C 85-1586 A

SUZANNE KIRKPATRICK, DOROTHY D. CASLER, and CHARLES H. LINDSEY,

Plaintiffs,

vs.

J.C. BRADFORD & CO.,

Defendants.

CIVIL ACTION No. C 85-1891 A

March 27, 1986

ORDER

VINING, District Judge.

In these federal securities actions, the plaintiffs have filed motions for class certification, pursuant to Rule 23 of the Federal Rules of Civil Procedure. The court already has considered and ruled on the defendants' motions to dismiss and numerous discovery and procedural motions. These cases are now ripe for a determination of whether they may proceed as class actions.[1] An understanding of the history of the Petro-Lewis cases is necessary before the court considers the motions for class certification.

I. HISTORY OF THE PETRO-LEWIS LITIGATION

From 1970 to 1983, Petro-Lewis was the nation's largest seller of oil and gas income funds. These programs raised money from investors, who became limited partners, and used the proceeds to purchase oil and gas producing properties. Cash distributions to the limited partners, which were paid quarterly, began almost immediately after each partnership was formed and were to continue for 10 to 15 years or more until the wells were depleted. Petro-Lewis, an independent oil and gas producer and manager of petroleum investments for public and private partners, acquired oil and gas properties for public limited partnerships, shared ownership of those properties, and managed the limited partnerships as a general partner. Over a 14-year period, Petro-Lewis sold, through securities brokerage firms, in excess of $3 billion worth of partnerships to approximately 180,000 people.

As oil and gas prices began to decline in 1981 and 1982, Petro-Lewis was forced to borrow funds to pay partnership distributions, service the debt it was incurring, and promote the sale of additional programs. In February 1984 Petro-Lewis revealed that it would sustain a substantial loss, that it was cutting

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[1] On October 28, 1985, this court held that a companion case, *Chandler v. Drexel Burnham Lambert, Inc.*, C85-1585A (N.D. Ga. 1985), should be sent to arbitration. The plaintiff has appealed that decision to the Eleventh Circuit Court of Appeals.

distributions to limited partners by as much as 50 percent, that the company would have to sell between one quarter and one third of its total reserves to reduce bank debt, and that Petro-Lewis was immediately terminating all sales of partnership programs. Numerous lawsuits against Petro-Lewis followed.

In In re Petro-Lewis Securities Litigation [1984-85 Transfer Binder], Fed. Sec. L. Rep. ¶ 91,899 (D. Colo. 1984), the court set forth the history of the Petro-Lewis litigation that lead to these class actions.[2] In that case, the court consolidated eleven class actions filed between February 9, 1984, and May 9, 1984. The defendants were the Petro-Lewis Corporation, the Petro-Lewis Funds, Petro-Lewis Securities Corporation, and the seven directors of Petro-Lewis Corporation. The amended consolidated class action complaint set forth claims under the Securities Exchange Act of 1934, as amended, 15 U.S.C. §§ 78a, *et seq.*, and the Securities Act of 1933, as amended, 15 U.S.C. §§ 77a, *et seq.* The plaintiffs in the original Colorado action sought to represent two classes: (1) a "securities class," consisting of the purchasers of securities, including common stock, warrants, and preferred stock, and (2) a "partnership class," consisting of persons who purchased, reinvested in, or otherwise acquired limited partnership interests in over 100 partnerships formed by Petro-Lewis to purchase oil and natural gas producing properties between August 1975, and February 1984, and in the Petro-Lewis deferred income program formed in 1981. The Petro-Lewis complaint alleged that during the relevant times the defendants made, or caused to be made, statements in Petro-Lewis prospectuses, periodic shareholder and investor reports, filings with the Securities and Exchange Commission, press releases, investor letters, and other documents, that were materially false and misleading and that the defendants omitted to disclose certain material facts and adverse information about Petro-Lewis and the partnerships that it managed. Some plaintiffs sought relief in the form of rescission of their purchases of limited partnership interests. All plaintiffs sought damages, interest, costs, and disbursements.

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[2] The facts set forth in part I are taken from Judge Carrigan's opinion in the Colorado litigation.

On July 3, 1984, co-lead counsel for the plaintiffs and counsel for the defendants in the Colorado litigation executed an agreement in principle to settle all eleven class actions. The settlement agreement consisted of two primary components: (1) formation of a royalty trust, and (2) creation by the defendants of a settlement fund consisting of cash and non-cash considerations valued at $23.5 million. Notices were sent to approximately 180,000 holders of limited partnership interests in 45 limited partnerships, plus approximately 7,000 members of the stockholder class. In addition, 40,000 notices were sent to brokers for forwarding to persons on whose behalf interests were held. According to a public announcement made December 26, 1984, all 45 affected limited partnerships voted, by very substantial margins, in favor of the settlement. The settlement required Petro-Lewis, on behalf of all defendants, to contribute consideration of $23.5 million to a settlement fund, which included $10 million in cash plus approximately 720,000 trust units valued at $13.5 million.

The class members who participated in the settlement were to sign a release form which provided that all the defendants, and any subsidiary or affiliate of Petro-Lewis, would be released with respect to all claims, demands, and causes of action. The release form, however, was not intended to release any broker-dealer in its capacity as an agent for Petro-Lewis or any of its affiliates in connection with the issuance, purchase, or sale of any of the securities of, or interest in, Petro-Lewis, or any of the limited partnerships of which Petro-Lewis or any subsidiary or affiliate of Petro-Lewis was a general partner. Counsel for all parties agreed that the purpose and intent of the release was solely to protect the defendants in the Colorado action and that it was intended that all the plaintiff class members retain any rights that they might have to proceed against and collect from broker-dealers or other nondefendants who might be liable to them.

The court conditionally certified the partnership class and the securities class for purposes of settlement only. The court indicated that there were serious questions of law and fact which

placed the outcome of the class actions, if tried rather than settled, in substantial doubt. One such question was:

> In view of the substantial number of distinct partnerships and the variations in facts relevant to, and potential conflicts among, the claims of those partnerships, there is doubt whether this action could be certified under Fed. R. Civ. P. 23 (except conditionally, for settlement purposes) and, if certified, whether the partnership class would have to be splintered into numerous subclasses.
>
> ¶ 91,889 at 90,470.

After carefully examining the proof of claim and release forms and the notices to be sent out, the court approved the proposed settlement as fair, reasonable, and adequate for all members of the plaintiff classes.

II. THE INSTANT LITIGATION

The plaintiffs seek to represent individuals who purchased, reinvested in, or acquired from the defendants limited partnership interests in Petro-Lewis income programs from January 1, 1981, to February 6, 1984. The amended complaints in these three proposed class actions are divided into three parts. The plaintiffs spend 30 pages setting forth the alleged wrongdoings by Petro-Lewis. For example, the amended complaint alleges that statements made in the Petro-Lewis prospectuses from 1981 to 1984 were false and misleading because they did not disclose the risks inherent in purchasing Petro-Lewis partnership interests. Amended Complaint ¶ 22.[3] Petro-Lewis also allegedly failed to disclose excessive leveraging of all partnerships, made unsecured loans to partnerships to inflate distributions to limited partners and to attract new sales, made false and misleading financial statements, annual and periodic reports, press releases

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[3] References to paragraphs in this part of the order refer to the *Sanders v. Robinson-Humphrey* amended complaint, although the other two amended complaints are substantially similar.

and newsletters, and failed to disclose that substantial tax benefits expected to be received by limited partnership investors were likely to be disallowed. *Id.* at ¶¶ 22-23. Petro-Lewis also allegedly failed to inform the investing public of the risks involved in the Petro-Lewis method of operation, including competition in the industry by less risky investment programs and the severe difficulty of obtaining debt servicing. *Id.* at ¶ 23.

A *Wall Street Journal* article on April 5, 1983, reported that Petro-Lewis was "facing an apparent cash squeeze that might lead to nasty surprises for holders." The article stated that Petro-Lewis had " 'leveraged' or invested in a larger value of oil properties than the original cash put up." *Id.* at ¶ 24. Petro-Lewis issued a press release denying substantially all of the statements made in the *Wall Street Journal* article and allegedly maintained artificially high distribution to the partnerships to attract new partnership sales. *Id.* Finally, on February 6, 1984, Petro-Lewis allegedly revealed the following: that it had severe losses, that it was cutting its distribution by 50 percent, that it was reducing the price at which Petro-Lewis agreed to repurchase partnership interests, that it was drastically reducing its work force, and that it was immediately terminating all sales of partnership programs. *Id.* at ¶¶ 35-36. At the time Petro-Lewis made these revelations, reserves bought by many partnerships were worth only 1/3 to 1/2 what the partnerships paid for them. *Id.* at ¶ 36.

In the second part of the complaints, the plaintiffs set forth the defendants' alleged roles in the sales scheme. According to the complaints, Petro-Lewis partnership interests were marketed by selected members of the National Association of Securities Dealers, including the defendants in this action, pursuant to selling agreements with Petro-Lewis securities corporation, a wholly owned subsidiary of Petro-Lewis. Each brokerage house allegedly received sales commissions of up to seven percent on each partnership interest sold, plus a special sales incentive payment of 1-1/2 percent when the brokerage house's sales in a program exceeded $400,000. *Id.* at ¶ 38. Sales of the Petro-Lewis partnership interests allegedly were a significant source of

revenue and profit to the defendants. *Id.* at ¶ 40. The plaintiffs contend that the defendants trained and instructed their account representatives in standard techniques to promote, solicit, sell, and induce customers to purchase Petro-Lewis partnership interests. During the class period, the defendants allegedly provided to the plaintiffs and the proposed classes the prospectuses, financial statements, annual and periodic reports, press releases, and other statements described in part I of the complaints. In addition, the plaintiffs assert that the defendants made numerous uniform statements of fact and verbal assurances to the plaintiffs and the members of the proposed classes to the effect that Petro-Lewis' public statements were worthy of the plaintiffs' trust and belief, that Petro-Lewis was operating soundly, and that Petro-Lewis partnerships were good investments from which high long-term yields could be expected at minimal risk. *Id.* at ¶ 41.

The defendants allegedly knew or recklessly disregarded information available to them which disclosed or would have disclosed the financial problems of Petro-Lewis and its partnerships as described in part I of the complaints. *Id.* at ¶ 43. Even though the defendants allegedly knew or should have known these facts, they continued to market and sell Petro-Lewis partnership interests to the plaintiffs and members of the proposed classes during the class period without disclosing any of the facts asserted in part I of the complaints. The plaintiffs assert that the defendants characterized the Petro-Lewis partnership interests as relatively low risk investments when they were clearly known to be high risk investments and that the defendants uniformly dissuaded and discouraged customers, including the plaintiffs and the members of the proposed classes, from selling or liquidating their interests in the Petro-Lewis partnership programs. *Id.* at ¶ 44. The plaintiffs allege that the defendants knew or recklessly disregarded facts contributing to Petro-Lewis' financial problems, the vulnerability of Petro-Lewis' partnership programs caused by the pattern of excessive leveraging instituted by Petro-Lewis management, and the high degree of risk involved in any investment in the Petro-Lewis partnership

programs. *Id.* at ¶ 45. The plaintiffs and their proposed classes allege that as a result of the foregoing, they were damaged. *Id.* at ¶ 46.

Part III of the amended complaints sets forth the seven counts that form the basis of this lawsuit. Count I, brought pursuant to section 11 of the Securities Act of 1933, 15 U.S.C. § 77k, alleges that the defendants issued, caused to be issued, participated in the issuance of, or aided and abetted the issuance of materially false and misleading statements to the investing public that appeared in publicly disseminated materials relating to Petro-Lewis and its partnership programs during the class period, including the registration statements and the prospectuses that misrepresented and failed to disclose the facts set forth in part I of the complaints. *Id.* at ¶ 53. Count II, brought pursuant to section 12(2) of the Securities Act, 15 U.S.C. § 77*l*(2), alleges that the defendants made untrue statements of material fact or omitted to state material facts in the prospectuses, newsletters, releases, and instruction booklets. The defendants also allegedly used the means and instruments of transportation or communication in interstate commerce or the mails to perform these violations of section 12(2). *Id.* at ¶ 58.[4] Count III, brought pursuant to section 15 of the Securities Act, 15 U.S.C. § 77o, the "controlling person" liability provision for sections 11 and 12, alleges that the named defendants directly or indirectly controlled the activities of the brokerage houses as underwriters of the Petro-Lewis partnership interests and programs and were responsible for the content of the Petro-Lewis registration statement and prospectuses during the class period, or directly or

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[4] In all three class action cases, the defendants filed motions to dismiss, contending that section 13 of the Securities Act, 15 U.S.C. § 77m, the statute of limitations for sections 11 and 12(2), barred these counts. In *Sanders v. Robinson-Humphrey*, the court dismissed the plaintiffs' claims for their 1981 purchases. *See* Order filed Sept. 11, 1985. In *Kirkpatrick v. J. C. Bradford*, the court dismissed Counts I and II since the claims were barred by the statute of limitations. The court allowed the plaintiffs' attorneys to communicate with potential class members in an attempt to find plaintiffs not barred by the statute of limitations. *See* Order filed Sept. 11, 1985. In *Parker v. Paine Webber*,

(Footnote continued)

indirectly induced the acts alleged in Counts I and II. *Id.* at ¶ 64.[5] Count IV alleges a cause of action under sections 10 and 20 of the Securities Exchange Act of 1934, 15 U.S.C. § 78j and § 78t, and Rule 10b-5, 17 C.F.R. § 240.10b-5.[6]

In addition to the federal securities claims, the plaintiffs allege common law fraud and deceit (Count V), negligence and negligent misrepresentation (Count VI), and fraudulent concealment and breach of fiduciary duty (Count VII). The amended complaint in *Parker v. Paine Webber* also alleges a cause of action under the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. § 1962(c).

Each of the complaints demand judgment against the defendants for compensatory damages, the costs and disbursements of the action, including reasonable attorneys' fees, and punitive and exemplary damages in the amount of $10 million. In addition, the plaintiffs requested that this court determine that these complaints may proceed as class actions under Rule 23 of the Federal Rules of Civil Procedure.

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the court dismissed Counts I and II. *See* Order filed Sept. 11, 1985. The plaintiffs amended their complaint, and the court denied the defendant's motion to dismiss Counts I and II of the amended complaint. *See* Order filed Feb. 14, 1986.

[5] A claim against a controlling person is governed by the same limitations period that applies to the Securities Act claim against the controlled person. This court held that section 13, therefore, also applied to the plaintiffs' section 15 claim. *See Herm v. Stafford*, 663 F.2d 669, 679 (6th Cir. 1981). As a result, Count III in *Kirkpatrick* was dismissed. *See* Order filed Sept. 11, 1985. The amended complaint in *Parker v. Paine Webber* did not allege a cause of action under section 15.

[6] The cause of action under section 20 was dismissed in *Kirkpatrick v. J. C. Bradford* and not alleged in the amended complaint in Parker v. Paine Webber.

The defendants, in their motions to dismiss this count, alleged that the plaintiffs failed to plead fraud with sufficient particularity to satisfy Rule 9(b) of the Federal Rules of Civil Procedure. The court declined to dismiss on this ground. *See* Orders filed Sept. 11, 1985.

The parties have engaged in extensive preliminary discovery on the class certification question. The court held an evidentiary hearing on Febraury 27, 1986, and the parties submitted briefs before and after the hearing.

III. FRAMEWORK OF ANALYSIS

A party that seeks to invoke Rule 23 has the burden of proving that all of the prerequisites to utilizing the class action procedure have been satisfied. *Zeidman v. J. Ray McDermott & Co.*, 651 F.2d 1030, 1038 (5th Cir. 1981).[7] The burden of satisfying the requirements of Rule 23 falls on the party who seeks to maintain a class action. *Amswiss International Corp. v. Heublein, Inc.*, 69 F.R.D. 663, 665 (N.D. Ga. 1975). Questions concerning class certification are left to the sound discretion of the trial court. *Freeman v. Motor Convoy, Inc.*, 700 F.2d 1339, 1347 (11th Cir. 1983).

The question of class certification is a procedural one, distinct from the merits of the action. *Garcia v. Gloor*, 618 F.2d 264, 267 (5th Cir. 1980), *cert. denied*, 449 U.S. 1113, 101 S.Ct. 923, 66 L.Ed.2d 842 (1981). The court may not inquire into the merits of this case because the Supreme Court has held that "nothing in either the language or history of Rule 23 . . . gives a court any authority to conduct a preliminary inquiry into the merits of a suit in order to determine whether it may be maintained as a class action." *Eisen v. Carlisle & Jacquelin*, 417 U.S. 156, 177, 94 S. Ct. 2140, 2152, 40 L.Ed.2d 732 (1974). "[T]he question is not whether the plaintiff or plaintiffs have stated a cause of action or will prevail on the merits, but rather whether the requirements of Rule 23 are met." *Id.* at 178, 94 S. Ct. at 2153.[8]

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[7] In *Bonner v. City of Prichard*, 661 F.2d 1206, 1209 (11th Cir. 1981)(*en banc*), the Eleventh Circuit adopted the law of the Fifth Circuit prior to October 1, 1981, as binding precedent.

[8] After citing *Eisen*, however, Professor Arthur Miller points out that "there is no way the judge can make the . . . findings required by Rule 23 without

(Footnote continued)

The court must make seven affirmative findings before this case may be certified as a class action. First, the plaintiffs must establish two prerequisites not expressly stated in Rule 23 that have been developed by the courts. Then, the plaintiffs must demonstrate that they have met the requirements of Rule 23(a). Finally, the plaintiffs must prove that these cases fall within one of the three categories of class actions in Rule 23(b).

Although not specifically mentioned in Rule 23, the first essential prerequisite of a class action is that there must be a class. 7 C. Wright & A. Miller, *Federal Practice and Procedure: Civil* § 1760 at 579 (1972). The class action complaints allege that these actions were brought on behalf of individuals who purchased, reinvested in, or acquired limited partnership interests in Petro-Lewis income programs from January 1, 1981, to February 6, 1984. These individuals form the class. Once a court determines that a class exists, it then must ascertain whether the named representatives are members of the class they purport to represent. *Id.* at § 1761, at 584; *see East Texas Motor Freight v. Rodriguez*, 431 U.S. 395, 403, 97 S. Ct. 1891, 1896, 52 L.Ed2d 453 (1976)(holding that "a class representative must be part of the class and 'possess the same interest and suffer the same

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at least a preliminary exploration of the merits. This will not be to ascertain who is going to win and who is going to lose, but simply to develop some feel for the contours of the case." A. Miller, *An Overview of Federal Class Actions: Past, Present and Future*, 15 (Federal Judicial Center 2 ed. 1977). The Eleventh Circuit agrees with Miller:

> While it is true that a trial court may not properly reach the merits of a claim when determining whether class certification is warranted, *Miller v. Mackey International, Inc.*, 452 F.2d 424, 428 (5th Cir. 1971), this principle should not be talismanically invoked to artifically limit a trial court's examination of the factors necessary to a reasoned determination of whether a plaintiff has met her burden of establishing each of the Rule 23 class action requirements. *Love v. Turlington*, 733 F.2d 1562, 1564 (11th Cir. 1984).

injury' as the class members"). Because the plaintiffs clearly purchased their limited partnership interests within the class period, they are clearly members of the class.

Having satisfied the two implied prerequisites for a class action, the plaintiffs have the burden of making a positive showing that they fulfill all the requirements of Rule 23(a) and that the action falls within one of the categories of Rule 23(b). *See Amswiss International Corp. v. Heublein, Inc.*, 69 F.R.D. 663, 665-66 (N.D. Ga. 1975). The court now turns to Rule 23.

IV. RULE 23(a)

A class action "may only be certified if the trial court is satisfied, after a rigorous analysis, that the prerequisites of Rule 23(a) have been satisfied." *General Telephone Co. of the Southwest v. Falcon*, 457 U.S. 147, 161, 102 S. Ct. 2364, 2372, 72 L.Ed.2d 740 (1982). Rule 23(a) provides:

> *Prerequisites to a Class Action.* One or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.

The court addresses each of these subdivisions in turn.

A. *Rule 23(a)(1): Numerosity*

Numerosity is not in dispute in this case. Joinder of all class members clearly would be impracticable. A plaintiff need not specify an exact number of class members, but must show only that joinder is impracticable through "some evidence or reasonable estimate of the number of purported class members." *See Zeidman v. J. Ray McDermott & Co.*, 651 F.2d 1030, 1038

(5th Cir. 1981). The plaintiffs in *Kirkpatrick* and *Sanders* have offered evidence showing that there are approximately 8,000 individuals who are potential class members. None of the defendants contends that the plaintiffs have not met the numerosity requirement.

B. *Rule 23(a)(2): Commonality*

To satisfy Rule 23(a)(2) the plaintiff must establish the existence of questions of law *or* fact common to the class. This provision does not require that all class members share the exact same legal claims. *Johnson v. American Credit Co. of Georgia*, 581 F.2d 526, 532 (5th Cir. 1978). The commonality requirement is satisfied where the questions of law or fact linking the class members are substantially related to the resolution of the litigation even though the individuals are not identically situated. *See Kleiner v. First National Bank of Atlanta*, 97 F.R.D. 683, 691 (N.D. Ga. 1983). The court notes that because Rule 23(a)(2) requires "questions of law or fact," more than one issue of law or fact must be common to the members of the class.

The plaintiffs list numerous questions of law or fact that clearly satisfy this requirement: (1) whether the prospectuses and other sales literature distributed by the defendants to the plaintiffs and the class contain material misrepresentations of fact or omit material facts concerning the safety and investment worth of the Petro-Lewis partnerships; (2) whether, during the class period, the defendants concealed material information about the precarious financial condition of Petro-Lewis and its partnerships; (3) whether the defendants concealed the truth about the historical performance of the Petro-Lewis partnerships; (4) whether the defendants misrepresented the future business prospects of Petro-Lewis and its partnerships programs; and (5) whether the defendants violated the federal securities laws and the common law in connection with their sales of limited partnership interests in the Petro-Lewis programs during the class period.

In most cases, neither the parties nor the courts spend much time discussing the commonality requirement. In general, courts

that have focused on Rule 23(a)(2) have given it a permissive application so that common questions have been found to exist in a wide range of contexts. 7 C. Wright & A. Miller, *Federal Practice and Procedure: Civil* § 1763 at 604 (1972).[9]

C. *Rule 23(a)(3): Typicality*

Rule 23(a)(3) insists that the class representatives have typical claims or defenses.[10] A representative's claim is typical of the class if it arises from the same event, practice, or course of conduct that gives rise to the claims of the absent class members and if the individual claims are based on the same legal or remedial theory. *Davis v. Northside Realty Associates, Inc.*, 95 F.R.D. 39, 43 (N.D. Ga. 1982); *see Gonzales v. Cassidy*, 474 F.2d 67, 71 n.7 (5th Cir. 1973)(holding that representative was "typical of the class within the meaning of Rule 23(a)(3) because he did not have interests which conflicted with those of the class, . . ."). The Supreme Court has held that typicality is met when a "class representative [is] part of the class and 'possess[es] the same interests and suffer[s] the same injury' as the class members." *East Texas Motor Freight System, Inc. v. Rodriguez*, 431 U.S. 395, 403, 97 S. Ct. 1891, 1896, 52 L.Ed.2d 453 (1976).

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[9] It is important to distinguish between Rule 23(a)(2) and Rule 23(b)(3). Rule 23(b)(3) provides that common questions must *predominate* to have a class action under Rule 23(b)(3). This requirement is discussed more fully in part V.

[10] Professor Arthur Miller is skeptical about the usefulness of this requirement:

> But in the case of subdivision (a)(3), there does not seem to be *any* function it performs that is not accomplished by some other portion of the Rule. . . . But if the plaintiffs are class members (an implied requirement), and there are common questions (Rule 23(a)(2)), and the class is adequately represented (Rule 23(a)(4)), it is very, very difficult to identify anything that is added by "typicality." The other prerequisites will ensure "typicality" among the class members' claims or defenses.

A. Miller, *An Overview of Federal Class Actions: Past, Present and Future*, 26 (Federal Judicial Center 2 ed. 1977) (emphasis in original).

The degree of investment experience or sophistication of the class representatives is irrelevant. *Kennedy v. Tallant*, 710 F.2d 711, 717 (11th Cir. 1983). The complaints allege that the defendant committed the same unlawful acts by the same method against an entire class. All members of the class, therefore, may have similar claims. Thus, the plaintiffs have met the typicality requirement. *See id.* Even though class members purchased different Petro-Lewis limited partnership interests, the plaintiffs allege that the defendants engaged in a uniformly fraudulent course of conduct, disseminated virtually identical false prospectuses, financial statements, and other financial information, and failed to disclose material information regarding the operations of Petro-Lewis to purchasers during the class period. When plaintiffs have alleged such a common course of conduct, courts consistently have found no bar to class certification even though members of a class may have purchased different types of securities or interests, or purchased similar securities at different times.

When weighing the prerequisites of Rule 23, the Eleventh Circuit has held that "subsection (a)(3) primarily directs the district court to focus on whether named representatives' claims have the same essential characteristics as the claims of the class at large. Moreover, "the typicality requirement may be satisfied even if there are factual distinctions between the claims of the named plaintiffs and those of other class members." *Appleyard v. Wallace*, 754 F.2d 955, 958 (11th Cir. 1985)(citations omitted). The court clearly finds that the plaintiffs' claims are typical of the classes they seek to represent. "[T]he typicality requirement is not so rigid as to comprehend only similar fact situations . . . it would be a better test of typicality to consider whether the types of facts or evidence were typical of the class." *Walker v. Jim Dandy Co.*, 638 F.2d 1330, 1336 (5th Cir. 1981).

D. *Rule 23(a)(4): Adequacy of Representation*

Rule 23(a)(4) is the most important prerequisite in Rule 23(a). *See* A. Miller, *An Overview of Federal Class Actions: Past, Present and Future*, 27 (Federal Judicial Center 2 ed. 1977). This provision requires a showing that the class representative will

fairly and adequately protect the interests of the class. By far it is the most heavily litigated of the prerequisites. *Id.* at 28. Professor Miller states:

> The class or representative action represents an exception to the principle of an individual right to a day in court. The justification for permitting it is that considerations of efficiency and economy and good practice permit issuing an order or rendering a judgment that binds everyone in a defined group who was properly represented before the court and therefore has had a day in court vicariously. It is Rule 23(a)(4) that ensures the quality of that representation and the integrity of the system. Unless there has been fair and adequate representation, due process has not been satisfied and any attempt at binding the absentee is improper. *Id.*

See Hansberry v. Lee, 311 U.S. 32, 44-46, 61 S. Ct. 115, 119-20, 85 L.Ed. 22 (1940)(discussing due process under Rule 23(a)(4)).

Courts traditionally hold that to satisfy Rule 23(a)(4) the plaintiff must meet two tests. First, the plaintiff's attorney must be qualified, experienced, and generally able to conduct the proposed litigation. *Gonzales v. Cassidy*, 474 F.2d 67, 73 n.10 (5th Cir. 1973); *Schatzman v. Talley*, 91 F.R.D. 270, 273 (N.D. Ga. 1981). Based on the plaintiffs' attorneys' performance in these cases thus far, as seen through the discovery, briefs, and motions, and the hearing before the court, the court has no reason to question the competency of the plaintiffs' attorneys. They have demonstrated a clear understanding of the issues in these cases and the competence and ability to conduct sophisticated securities litigation.

The second requirement under Rule 23(a)(4) is that the plaintiffs must not have interests antagonistic to those of the class. *Gonzales*, 474 F.2d at 73 n.10; *Schatzman*, 91 F.R.D. at 373. Courts interpreting this prerequisite have held that "the primary criterion is the forthrightness and the vigor with which the representative party can be expected to assert and defend the

interests of the members of the class." *See Schatzman*, 91 F.R.D. at 273. The named plaintiffs have failed to impress the court that they will vigorously prosecute these class actions. The representatives are not sufficiently interested in the outcome of these actions to protect adequately the rights of the potential class members. The plaintiffs' failure in this respect is fatal to their motions for class certification.

The court notes that while each of the reasons given below is not determinative, the "totality of the circumstances" indicates that the plaintiffs have failed to satisfy Rule 23(a)(4).

> First, in the hearing the court stated: It concerns me deeply today that as far as I know none of the named plaintiffs showed up for this hearing and in fact when a subpoena was issued for them they resisted. I did not require them to appear simply because I thought if they were interested in the litigation they ought not to have to be subpoenaed to appear. Transcript of hearing, Feb. 27, 1986, at 114-15.

The plaintiffs contend that the defendants subpoenaed the plaintiffs merely to harass them. At the hearing, the court was not concerned with the potential for harassment, but rather with the plaintiffs' reluctance to vigorously prosecute these class actions. The plaintiffs' failure to show up for the hearings indicates a lack of interest.

Second, the plaintiffs cannot act as representatives for the state and common law claims because these claims vary from state to state. In addition, different state statutes of limitation govern the section 10(b) claims. These differences are discussed more fully in part V, sections C and D.

In *Sanders*, Glenn Sanders stated that he had little or no involvement in preparing the complaint, which was investigated and drafted exclusively by his attorneys. Deposition of Glenn Sanders, pp. 85-86, 92-93. Sanders also was uncertain whether to proceed with this action if the class was not certified. *Id.* at

p. 114. Sanders did not know the identity of the individual defendants named in the complaint. *Id.* at pp. 94-96.

Leslie Sanders, the other named plaintiff in the *Sanders* case, indicated that she did not want to be involved in this case and did not agree to become one of the named plaintiffs until counsel for the plaintiffs called her one month before her deposition. Deposition of Leslie Sanders, pp. 49-52. Ms. Sanders did not contribute to the complaint or the amended complaint, and she never saw the amended complaint until a couple of days before the deposition. *Id.* at p. 50. In addition, Ms. Sanders did not know the name of one of the firms that was representing her. *Id.* at p. 3. Furthermore, Ms. Sanders stated that her claim does not concern her initial decision to purchase securities, as the complaint alleges, but that in 1983 Robinson-Humphrey purportedly told her not to sell her securities. *Id.* at pp. 43, 54. Ms. Sanders also did not know the identity of the individual defendants. *Id.* at pp. 55-56. Chip Traynor, the broker who allegedly fraudulently sold securities to Ms. Sanders, still acts as a broker for her and almost all her family. Deposition of Chip Traynor, p. 232. If the Sanders truly felt that their broker defrauded them, presumably he would no longer be their broker.

In *Kirkpatrick*, plaintiff Charles Lindsey purchased limited partnership interests through his brother, a broker for J.C. Bradford. In deposition, Lindsey stated:

> Q. Is it your belief that they [the defendants] tried to defraud the investing public, or do you think they're just guilty of mismanagement, or do you have—
>
> A. I don't know. I don't think you can say that somebody was really planning to defraud me. Petro-Lewis was a reputable firm and was on the New York Stock Exchange and what have you. Petro-Lewis is not a fly-by-night. I mean, they were a pretty reputable firm. I don't think Bradford's people kept up with it. That's pure and simple what happened.

Q. You think they were negligent?

A. Absolutely, positively. . . .

Deposition of Charles Lindsey, pp. 60-61. Lindsey was careful to point out that the allegations of paragraph 5 of the complaint – to the effect that he purchased pursuant to a prospectus – were in error. While insisting that he would let the chips fall where they might against his brother, Lindsey admitted that his family would be upset if he sued his brother. *Id.* at p. 57.

Similarly, plaintiff Suzanne Kirkpatrick still has an account with the person from whom she purchased her partnership interests in Petro-Lewis, although he no longer works for J. C. Bradford. Deposition of Suzanne J. Kirkpatrick, p. 6. In her deposition, Kirkpatrick stated:

Q. . . . Is it your belief or your contention that Bradford was trying to defraud you or was trying to sell you something they knew or should have known was no good?

A. No, sir, but I think they should have done their homework before they made the sales.

Q. You think they were negligent in failing to find this out?

A. Yes.

Id. at p. 69.

The other named plaintiff in *Kirkpatrick*, Dorothy Casler, purchased her interests in Petro-Lewis from her son. In deposition, she testified:

Q. Have you sued your son over his selling you this Petro-Lewis?

A. No.

> Q. Well, you sued Bradford and I was wondering if you sued him since he's the one that put you into it?
>
> A. No.
>
> Q. Is there any reason why you haven't?
>
> A. Because I think he – in his mind he thought it was the best thing that I could do.

Deposition of Dorothy Casler, p. 8. In addition, Casler's son did not disclose to her the risks which, as the complaint alleges, were disclosed in the prospectus concerning a possible decline in the price of oil and the fact that Petro-Lewis was borrowing money to make the property acquisitions. *Id.* at pp. 48-49. In fact, Casler says she thought there were virtually no risks involved because her son knew that she could not take risks. *Id.* at p. 38. Casler expressed shock at the possibility that her claim might give rise to a lawsuit against her son. *Id.* at p. 42.

In summary, the court finds that the plaintiffs in their deposition testimony in *Sanders* and *Kirkpatrick* demonstrate a lack of interest in the vigorous prosecution of this lawsuit. Glenn and Leslie Sanders are not involved or knowledgeable enough to effectively prosecute a class action. *See Schatzman v. Talley*, 91 F.R.D. 270, 273 (N.D. Ga. 1981). The plaintiffs in *Kirkpatrick* do not believe, or are unwilling to prosecute, their fraud claims. For these reasons, the plaintiffs would not fairly and adequately represent the other class members. *See Rothenberg v. Security Management Co.*, 667 F.2d 958, 962-63 (11th Cir. 1982).

V. RULE 23(b)

If the four prerequisites of Rule 23(a) are satisfied, a suit may be maintained as a class action only if it falls within one of the three categories set forth in Rule 23(b). *See George v. United Federal Savings and Loan Association*, 63 F.R.D. 631, 636 (N.D. Ga. 1974). Even assuming that the plaintiffs satisfy Rule 23(a)(4), the court holds that they cannot satisfy Rule 23(b).

Rule 23(b) prescribes the various types of class actions that are permitted under the Federal Rules. It provides:

> (b) *Class Actions Maintainable.* An action may be maintained as a class action if the prerequisites of subdivision (a) are satisfied, and in addition:
>
> (1) the prosecution of separate actions by or against individual members of the class would create a risk of
>
> (A) inconsistent or varying adjudications with respect to individual members of the class which would establish incompatible standards of conduct for the party opposing the class, or
>
> (B) adjudications with respect to individual members of the class which would as a practical matter be dispositive of the interests of the other members not parties to the adjudications or substantially impair or impede their ability to protect their interests; or
>
> (2) the party opposing the class has acted or refused to act on grounds generally applicable to the class, thereby making appropriate final injunctive relief or corresponding declaratory relief with respect to the class as a whole; or
>
> (3) the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. The matters pertinent to the findings include: (A) the interest of members of the class in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; (D) the difficulties likely to be encountered in the management of a class action.

At the outset, the court notes that the parties do not rely on or discuss Rule 23(b)(1) or (b)(2). Because the plaintiffs do not

allege that these subdivisions apply, [11] the court turns to subdivision (b)(3).

Rule 23(b)(3) sets out two prerequisites that the plaintiffs must satisfy to maintain a class action under this subdivision: (1) questions of law or fact common to the members of the class must *predominate* over any questions affecting only individual members; and (2) the class action must be superior to other available methods for the fair and efficient adjudication of the controversy. A plaintiff must satisfy Rule 23(b)(3) to have a class action that involves securities fraud.

The court holds that because common questions of law and fact do not predominate, the plaintiffs cannot satisfy Rule 23(b)(3). The court arrives at this conclusion for four reasons. First, and most importantly, the alleged statements upon which the plaintiffs relied in purchasing Petro-Lewis securities were primarily oral rather than written and misrepresentations rather than omissions. The court, therefore, cannot imply the element of reliance central to the issue of this case. "[T]he most significant problem facing the [class] representatives under subdivision (b)(3) is to demonstrate that the representations made to and the reliance by each of the class members is not so divergent that common questions do not predominate." 7A C. Wright & A. Miller, *Federal Practice and Procedure: Civil*, § 1781 at 90 (1972). The plaintiffs have failed to overcome this problem. Second, many of the potential class members have signed arbitration agreements that oblige them to arbitrate their grievances. Third, the statute of limitations for section 10(b) varies from state to state, and in some states it is unknown. Last, because the purchasers of Petro-Lewis limited partnerships are from most of the 50 states, this court would be forced to apply the state and common law from each state in which a potential class member resides. The court addresses each of these problems in turn.

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[11] The plaintiffs may not rely on Rule 23(b)(2) because this subdivision only applies to injunctive or declaratory relief. "The subdivision does not extend to cases in which the appropriate final relief relates exclusively or predominately to money damages." Rule 23, Notes of Advisory Committee. The plaintiffs seek money damages.

A. *Oral Representations and Reliance*

The principal claims asserted by the plaintiffs are based upon alleged violations of section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934. To support a claim under section 10(b) and Rule 10b-5 the plaintiff must establish the following elements: (1) that a misstatement or omission has been made, (2) that the misstatement or omission pertains to material facts, (3) that the misstatement or omission was made with scienter, (4) that the plaintiff relied upon the misstatement or omission, and (5) that the misstatement or omission was the proximate cause of the injury to the plaintiff. *Huddleston v. Herman & MacLean*, 640 F.2d 534 (5th Cir. 1981)(*en banc*), *modified on other grounds*, 650 F.2d 815 (1981), *aff'd in part and rev'd in part on other grounds*, 459 U.S. 375, 103 S. Ct. 683, 74 L.Ed.2d 548 (1983). Each of these elements of a section 10(b) and Rule 10b-5 cause of action must be proven for the plaintiff to prevail.

Although a determination of class action generally does not permit investigation into the merits of a case, it is necessary in this situation in order to determine whether the common questions of law or fact predominate over individual questions of law or fact concerning the section 10(b) and Rule 10b-5 claims. The key factor in determining whether class action is appropriate is the matter of reliance. If it is determined that reliance is common to all members of the class, the class action will stand. If, however, reliance is found to be an individual element whereby each plaintiff must prove reliance upon misstatements and omissions, the class action status will not be available.

The element of reliance and its effect upon class certification have been handled by the courts in several different fashions. Reliance may be implied where the plaintiff alleges a course of fraudulent conduct common to all members of the class where misrepresentations or omissions upon which the fraud is based are uniform throughout the class. *In re Home Stake Production Co. Securities Litigation*, 76 F.R.D. 351 (N.D. Okla. 1977). It may be implied where the course of fraudulent conduct is perpetrated by way of oral representations where information material to the decision to purchase has been omitted.

Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128, 92 S. Ct. 1456, 31 L.Ed.2d 741 (1972); *Kennedy v. Tallant*, 710 F.2d 711 (11th Cir. 1983); *Shores v. Sklar*, 647 F.2d 462 (5th Cir. 1981)(*en banc*), *cert. denied*, 459 U.S. 1102, 103 S. Ct. 722, 74 L.Ed.2d 949 (1983). Finally, reliance may be implied under the "Fraud on the Market" theory. *Lipton v. Documation, Inc.*, 734 F.2d 740 (11th Cir. 1984).

In an attempt to refute the requirement of reliance, the plaintiffs allege the following: (1) that the defendants have perpetrated a course of fraudulent conduct upon all members of the proposed classes by use of a uniform sales pitch in marketing Petro-Lewis securities, (2) that this is not a case of oral misrepresentations and omissions but one of written misrepresentations and omissions found in the prospectuses and other written materials issued by Petro-Lewis, and (3) that the defendants have perpetrated a "Fraud on the Market" with regard to Petro-Lewis securities.

The court finds that none of these allegations falls within the bounds required for implying the element of reliance necessary to justify class certification in a section 10(b) and Rule 10b-5 action.

The plaintiffs state that the defendants followed a fraudulent course of conduct in making sales of Petro-Lewis securities to the potential class members and rely upon *Kennedy* and *Home Stake* to support these allegations. A distinction must be made, however, between these two cases and the instant case. First, the suits in *Home Stake* and *Kennedy* were brought against the company issuing the securities involved rather than against the broker selling the securities. Second, the securities in *Home Stake* and *Kennedy* were sold by salesmen employed by the company issuing the securities rather than by brokerage firms promoting sales between the issuer and the purchaser as in the instant case. In circumstances such as those in *Home Stake* and *Kennedy*, the issuer has direct control over what information is disseminated to the purchasers as well as control over the means by which the information is transferred. In *Home Stake*, for instance, the issuer had a sales force promoting sales by use of a "black book," which was the central selling tool in each

presentation. The plaintiffs in the instant cases allege that a uniform sales program was used in presentations to prospective buyers who are potential class members. However, all the briefs, as well as information in the complaint, presented by the plaintiffs in support of a class action status assert facts pertinent only to the sales pitch by Petro-Lewis to each of the individual brokerage houses. Granted, the defendants could have used the sales materials presented by Petro-Lewis (and in the case of plaintiff Parker, did by way of a joint seminar presented by Petro-Lewis and Paine Webber). However, the plaintiffs have presented no materials whatsoever, developed through discovery or asserted by the individual plaintiffs, indicating a uniform presentation or "sales pitch" by the defendants to all the members of the proposed classes. Had the plaintiffs shown evidence of the uniform sales pitch by each of the defendants to the members of the proposed classes, then a fraudulent course of conduct by the defendants might be at issue and class action status might be warranted. The sales suggestions presented by Petro-Lewis to the defendant brokerage firms provide no guarantee that the brokerage firms would use the sales materials provided. The plaintiffs have failed to show that the materials provided were in fact used on a uniform basis or used at all by the defendants. The alleged common course of conduct was conduct between Petro-Lewis and the defendants rather than the defendants and the plaintiffs and cannot form the basis for dispensing with the reliance required in a section 10(b) and Rule 10b-5 action. Hence, the uniform scheme required to assume the element of reliance has not been alleged.

The plaintiffs contend that the defendants misrepresented and omitted certain facts from presentations made in sales of the Petro-Lewis securities and rely upon the prospectuses as the uniform sales tool used in the misrepresentations and omissions. The named plaintiffs acknowledge that they either did not read the prospectuses and relied entirely upon the information provided by their brokers,[12] or state that they read or looked through

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[12] In *Sanders v. Robinson-Humphrey*, both plaintiffs stated that they did not read the prospectus and in fact relied totally upon oral representations by their

(Footnote continued)

the prospectuses, but could not recall any specifics and also relied upon representations made by their brokers in deciding to purchase the Petro-Lewis partnership interests.[13] The plaintiffs assert that because the prospectuses were used in the sales of the securities, the misrepresentations and omissions presented in them provide a uniform presentation upon which common reliance can be based, and class certification need not depend upon whether the plaintiffs actually read the prospectuses. *Kennedy v. Tallant*, 710 F.2d 711 (11th Cir. 1983); *Affiliate Ute Citizens of Utah v. United States*, 406 U.S. 128, 92 S. Ct. 1456, 31 L.Ed.2d 741; *Shores v. Sklar*, 647 F.2d 462 (5th Cir. 1981)(*en banc*), *cert. denied*, 459 U.S. 1102, 103 S. Ct. 722, 74 L.Ed.2d 949 (1983); *Sharp v. Coopers & Lybrand*, 70 F.R.D. 544 (E.D. Pa. 1976). If misrepresentations are both oral and written and the plaintiffs relied upon the oral representations of their brokers, there is no standardized communication by the defendants and no basis for the assumption of reliance. *Simon v. Merrill Lynch*,

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brokers. *See* Deposition of Glenn Sanders, pp. 28-32, 35-36, 42, 46-49, 51-56; deposition of Leslie Sanders, pp. 19-29, 24-26, 31-32, 46. In *Kirkpatrick v. J.C. Bradford*, plaintiff Suzanne Kirkpatrick did not read a prospectus until after she made her purchase, deposition of Suzanne Kirkpatrick, p. 38, and relied totally upon J.C. Bradford's remarks concerning the Petro-Lewis investment. *Id.* at pp. 71-72. Plaintiff Dorothy Casler relied totally on her son, a broker for J.C. Bradford, in making her decision to purchase. Deposition of Dorothy Casler, pp. 35-36. As to plaintiff Charles Lindsey, Mr. Lindsey invested through his brother and relied totally upon what his brother told him. Deposition of Charles Lindsey p. 8.

[13] In *Parker v. Paine Webber*, both plaintiffs state that they looked at the prospectus. However, James Smith did not review the prospectus until after his first purchase of Petro-Lewis securities, deposition of James S. Smith, pp. 193-94, and when he finally did review the prospectus, was unable to point to specifics in the prospectus. When asked which portions of the prospectus were false and misleading, Mr. Smith stated, "I'm not able to do that, because it was an overall impression I got after talking to my broker, after this (indicating), it was may overall impression of the investment rather than the specifics from this document." *Id.* at p. 234. When Mr. Parker was questioned about reading the prospectus he stated, "I reviewed the prospectus. To be frank, you know, I was more interested in the pamphlet they had with all the pretty pictures in it." Deposition of Tommy E. Parker, p. 123. Smith later stated that in making his decision to purchase he relied on what Petro-Lewis and his broker said at the seminar which Mr. Parker attended. *Id.* at p. 39.

Pierce, Fenner & Smith, Inc., 482 F.2d 880 (5th Cir. 1973). The distinction here is that the cases relied upon by the plaintiffs were omissions cases whereas the instant cases primarily involve misrepresentations. The allegations stated in the complaints are almost entirely allegations of misrepresentations of material information presented in the prospectuses rather than the omission of material facts in the sale of Petro-Lewis securities. Where the misrepresentations and omissions are oral, precluding the uniformity of sales, rather than written, the court may infer reliance by the plaintiff in a section 10(b) and Rule 10b-5 action only where the defendant fails to disclose information material to the sale of the security. Where failure to disclose is material, the case is an omissions case. *Affiliated Ute, supra*; *Huddleston v. Herman & MacLean*, 640 F.2d 534 (5th Cir. 1981) (*en banc modified on other grounds*, 650 F.2d 815 (1981), *aff'd in part and rev'd in part on other grounds*, 459 U.S. 375, 103 S. Ct. 683, 74 L.Ed.2d 548 (1983)); *Simon, supra*; *Shores v. Sklar*, 647 F.2d 462 (5th Cir. 1981). "Where a 10b-5 action alleges defendant made positive misrepresentations of material information, proof of reliance by the plaintiff upon misrepresentations is required. Upon an absence of proof on the issue, plaintiff loses. On the other hand, where a plaintiff alleges deception by defendant's nondisclosure of material information, the *Ute* presumption obviates the need for plaintiff to prove actual reliance on the omitted information." *Rifkin v. Crow*, 574 F.2d 256, 262 (5th Cir. 1978) (footnote omitted).

This court has determined that the instant case is primarily one of a "misstatement or failure to state the facts necessary to make those statements made not misleading." *Huddleston*, 640 F.2d at 548. Because this case is one of misrepresentation, it is necessary that each class member prove his individual reliance upon the material misrepresentations made to him. Certification as a class action, therefore, is highly inappropriate. *Cavalier Carpets, Inc. v. Caylor*, 746 F.2d 749 (11th Cir. 1984); *Huddleston, supra*.

The plaintiffs' final attempt to procure a basis for the assumption of reliance is based upon the Fraud on the Market theory.

If the Fraud on the Market theory is accepted by the court, the element of reliance in a section 10(b) and Rule 10b-5 action is assumed because the reliance is based upon the integrity of the open market and sales of the security on the open market. *Lipton v. Documation, Inc.*, 734 F.2d 740 (11th Cir. 1984). This court has recognized the Fraud on the Market theory in *Shores* and *Lipton*, but has applied the theory only to securities traded on the open market. Although *Shores* involved the sales of new issue bonds, the bonds were traded on the secondary market after the original issue was released. Additionally, the plaintiff in *Shores* alleged that, but for the fraud, the bonds would not have been offered at all. Proof that they would have been issued at a higher or lower price would not have been sufficient for the plaintiff to recover.

The case at bar does not fall under the realm of the Fraud on the Market theory of *Shores* or *Lipton*. In the current action the plaintiffs do not allege that the securities would not have been sold had the misrepresentations not been present, nor have they shown that the securities were sold on the open market at the time of the purchases. The securities in fact were limited partnerships where liquidity was spelled out in the prospectus as being nonexistent except for the ability of Petro-Lewis to repurchase the interest. Petro-Lewis additionally set the price, the number of sales that were to be made, and also looked at the ability of each purchaser to withstand any losses that might result from a purchase of this nature. Hence these securities were not traded on the open market where such factors would not be present. In an open market the issuer would have no contact whatsoever with the purchaser, the issuer would not set the price for sale of the securities, and the issuer would not provide for repurchase of the security in the event the purchaser desired to sell. Moreover, in an open market, in order to sell, the purchaser only would have to set a price for sale of the security and have a broker place the order. These characteristics of an open market are not present in this cause of action. The plaintiffs, therefore, cannot rely upon the Fraud on the Market theory to provide the necessary reliance element of section 10(b) and Rule 10b-5 of the 1934 Act.

The court finds that the plaintiffs have not met the reliance requirement of section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934 and, therefore, cannot meet the predominance requirement of Rule 23(b)(3). This is an oral misrepresentation case and because the reliance requirement cannot be implied, each member of the class would be required to prove his reliance upon the misrepresentations and omissions in the purchase of Petro-Lewis securities.

B. *Arbitration*

In addition to the requirement of predominance of common issues over individual issues, Rule 23(b)(3) requires that the class action be "superior to other available methods for the fair and efficient adjudication of the controversy." At issue in both of these contexts is the right of the defendants to enforce arbitration agreements with members of the proposed classes. Each defendant has available the arbitration forum with some members of the proposed classes.[14]

As to all state claims where defendants have executed an arbitration agreement with purchasers of Petro-Lewis securities who fall into the proposed classes, it has been determined that the "Arbitration Act requires district courts to compel arbitration of pendent arbitrable claims where one of the parties files a motion to compel, even where the result would be the possible inefficient maintenance of separate proceedings in different forums." *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 105 S. Ct. 1238, 1241, 84 L.Ed.2d 158 (1985). Should any of the defendants move to arbitrate any of the class members' claims where a valid arbitration agreement is in existence, the court

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[14] Each of the defendants has alleged the existence of arbitration agreements with some members of the proposed classes. Although defendants Paine Webber and J.C. Bradford and Co. have not indicated the numbers that could be potentially involved in arbitration, Robinson-Humphrey has stated that those class members that could reach arbitration are between 50 and 70 percent of the total number of potential class members in the *Sanders v. Robinson-Humphrey* action.

would be required to compel arbitration and stay the current proceedings until such time as the arbitration is completed with regard to the state issues involved therein. *See Harris v. Shearson Hayden Stone, Inc.*, 82 A.D.2d 87, 441 N.Y.S.2d 70 (1981), *aff'd*, 56 N.Y.2d 62, 450 N.Y.S.2d 482, 435 N.E. 2d 1097 (1982); *Vernon v. Drexel Burnham & Co.*, 52 Cal.App. 3d 706, 125 Cal. Rptr. 147 (1975). Such a situation would be untenable, particularly in *Sanders*, where upwards of 70 percent of the proposed class members have executed arbitration agreements.

The plaintiffs assert that, because the Securities Act of 1933 is part of the litigation, arbitration of the federal claims is not enforceable. The 1933 Act claims are not subject to arbitration. *Wilko v. Swan*, 346 U.S. 427, 74 S. Ct. 182, 98 L.Ed. 168 (1953). However, the 1933 Act claims do not comprise the major issues in these cases. The plaintiffs contend that the claims under section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934 are also not subject to arbitration pursuant to the Eleventh Circuit ruling in *Gorman v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 780 F.2d 1032 (11th Cir. 1985). That case, however, is now *en banc* and no longer binding upon this court. This court is of the opinion, as stated in *Raiford v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, Civil Action No. C83-685A (N.D. Ga. May 16, 1985), and *Chandler v. Drexel Burnham Lambert, Inc.*, 633 F.Supp. 760 (N.D. Ga. 1985), that the 1934 Act claims are subject to the Arbitration Act and to arbitration agreements executed by the defendants and potential class members and must be sent, along with any state claims, to arbitration upon motion by the defendants. This opinion is supported by a number of recent Supreme Court cases including *Byrd, Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 103 S.Ct. 927, 74 L.Ed.2d 765 (1983), and *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, ____U.S.____, 105 S. Ct. 3346, 87 L.Ed.2d 444 (1985). The Supreme Court has established a strong tendency to favor use of the arbitration forum in the context of federal statutory claims. Indeed, in *Mitsubishi* the Court stated:

> We find no warrant in the Arbitration Act for implying in every contract within its ken a presumption against

> arbitration of statutory claims. . . . Nor is there any reason to depart from the federal policy favoring arbitration where a party bound by an arbitration agreement raises claims founded on statutory rights. *Mitsubishi*, 105 S. Ct. at 3355.

This policy favoring the arbitration agreement is based upon the " 'preeminent concern . . . to enforce private agreements into which parties had entered,' a concern which 'requires that we rigorously enforce agreements to arbitrate.' " *Id.* at 3356, citing *Dean Witter Reynolds v. Byrd*, 470 U.S. 213, 105 S. Ct. 1238, 1243, 84 L.Ed.2d 158 (1985).

In conjunction with the strong tendency of the courts to favor enforcement of arbitration agreements is the express provision in 28 U.S.C. § 2072 of the enabling act of the Federal Rules of Civil Procedure whereby Congress stated that the "rules shall not abridge, enlarge, or modify any substantive right . . . " Rule 23 is a procedural device provided by Congress to allow the court discretion in applying class action status to plaintiffs and those other class members similarly situated. The right to arbitration is contractual and therefore substantive. Congress did not intend that procedural class action certification be used to abrogate the contractual rights employed in the execution of the arbitration agreements by the defendants and some members of the proposed classes. To allow class certification where such arbitration agreements exist would not only be unduly burdensome and inefficient should defendants move to compel arbitration but would also violate the requirement of Rule 23(b)(3) that the class action be "superior to other available methods for the fair and efficient adjudication of the controversy." Fed. R. Civ. P. 23(b)(3).

C. *Rule 10b-5 Statute of Limitations*

Although the moment at which a section 10(b) action accrues and the statute of limitations begins to run is a matter of federal law, the time period itself is taken from state law. *Kennedy v. Tallant*, 710 F.2d 711, 716 (11th Cir. 1983). Under *Phillips Petroleum Co. v. Shutts*, ____ U.S. ____, 105 S. Ct. 2965, 2980, 86 L.Ed.2d 628 (1985), this court "may not take a transaction with little or no relationship to [Georgia] and apply [Georgia law]

in order to satisfy the procedural requirement that there be a 'common question of law.' " If the court certifies these class actions, it must apply the state statute of limitations for every state in which a class member resides. This court has held that where "the applicable statute of limitations . . . is dependent on state law . . . [the claims] are inappropriate for treatment as class actions because they present substantial and predominate [*sic*] individual questions." *Elster v. Alexander*, 76 F.R.D. 440, 442 (N.D. Ga. 1977), *appeal dismissed*, 608 F.2d 196 (5th Cir. 1979).

The time period within which a section 10(b) action must be brought varies from state of state. Courts have applied a one-year statute of limitations, *see, e.g., O'Hara v. Kovens*, 625 F.2d 15, 17 (4th Cir. 1980), *cert. denied*, 449 U.S. 1124, 101 S.Ct. 939, 67 L.Ed.2d 109 (1981) (Maryland); a two-year statute of limitations, *see, e.g., Diamond v. Lamotte*, 709 F.2d 1419, 1424 (11th Cir. 1983) (Georgia); *Gurley v. Documation, Inc.*, 674 F.2d 253, 259 (4th Cir. 1982) (Virginia); *White v. Sanders*, 650 F.2d 627, 633 (5th Cir. 1981) (Alabama); *Cook v. Avien, Inc.*, 573 F.2d 685, 694 (1st Cir. 1978) (Massachusetts); *Dupuy v. Dupuy*, 551 F.2d 1005, 1024 n.31 (5th Cir.), *cert. denied*, 434 U.S. 911, 98 S.Ct. 312, 54 L.Ed.2d 197 (1977) (Louisiana); *Nortek v. Alexander Grant & Co.*, 532 F.2d 1013, 1015 (5th Cir. 1976), *cert. denied*, 429 U. S. 1042, 97 S.Ct. 742, 50 L.Ed 2d 742 (1977) (Florida); *Dirksen v. Hynes & Howes Insurance Counselors, Inc.*, 423 F. Supp. 1290, 1293 & n.4 (S.D. Iowa 1976) (Iowa); a three-year statute of limitations, *see, e.g., Herm v. Stafford*, 663 F.2d 669, 677-78 (6th Cir. 1981) (Kentucky); *Jablon v. Dean Witter & Co.*, 614 F.2d 677, 682 (9th Cir. 1980) (California); *Nemkov v. O'Hare Chicago Corp.*, 592 F.2d 351, 355 (7th Cir. 1979) (Illinois); *Hilton v. Mumaw*, 522 F.2d 588, 601 (9th Cir. 1975) (Washington); *Burns v. Ersek*, 591 F. Supp. 837, 839 (D. Minn. 1984) (Minnesota); *Mid-Carolina Oil, Inc. v. Klippel*, 526 F. Supp. 694, 697 (D. S.C. 1981), *aff'd. mem.*, 673 F.2d 1313 (4th Cir.), *cert. denied*, 457 U.S. 1107, 102 S.Ct. 2906, 73 L.Ed.2d 1315 (1982) (South Carolina); *Ohio v. Peterson, Lowry, Rall, Barber & Ross*, 472 F. Supp. 402, 405-06 (D. Colo. 1979), *aff'd*, 651 F.2d 687 (10th Cir.), *cert. denied*, 454 U.S 895, 102 S. Ct. 392, 70 L.Ed.2d 209 (1981) (Colorado); a four-year statute of

limitations, *see, e.g., Gaudin v. KDI Corp.*, 576 F.2d 708, 711-12 (6th Cir. 1978) (Ohio); and six-year statute of limitations, *see, e.g., Roberts v. Magnetic Metals Co.*, 611 F.2d 450, 452 (3d Cir. 1979) (New Jersey); *IDS Progressive Fund, Inc. v. First of Michigan Corp.*, 533 F.2d 340, 344 (6th Cir. 1976) (Michigan); *Bartels v. Algonquin Properties Ltd.*, 471 F. Supp. 1132, 1147, 1149 (D. Vt. 1979) (Vermont).

In Hawaii, North Dakota, South Dakota, West Virginia, and Wyoming courts have not yet determined the applicable statute of limitations in a section 10(b) case. If this court were to certify a class, it would have to make that determination if a class member resided in one of these states.[15] In several states, the courts have applied different statutes of limitation. For example, in Connecticut the statute of limitations may be two years or three years. *Compare Clute v. Davenport Co.*, 584 F. Supp. 1562, 1577 (D. Conn. 1984) (two years) *with Klock v. Lehman Bros. Kuhn Loeb, Inc.*, 584 F. Supp. 210, 215-16 (S.D.N.Y. 1984) (holding Connecticut law has three-year statute of limitations). Nevada has a three-year limitation period for fraud, a two-year Blue Sky limitation period for fraud in the sale of securities, and a catch-all limitation period of four years. *See* Nev. Rev. Stat. §§ 11.190, 11.220, 90.200. This court, therefore, would have to determine which Nevada statute to apply. Finally, in Rhode Island, a court has indicated that either a six-year general statute of limitations or a three-year personal injury statute of limitations may apply. *See Holmes v. Bateson*, 583 F.2d 542, 561-62 (1st Cir. 1978).

If a class were certified, this court would be the first to determine the statute of limitations for 10(b) actions in numerous states. Given that some states never have ruled on the statute of limitations and other states have applied it with inconsistent results, individual questions of law clearly predominate. In

[15] In *Sanders* the defendants' attorney indicates that his examination of client mailing lists taken from the defendants' business files shows that the defendants sold Petro-Lewis limited partnership interests to clients maintaining addresses in 32 states, the District of Columbia, and West Germany. Supplemental Affidavit of Peter J. Anderson, ¶ 3.

addition, discovery would be necessary to determine what individual brokers told potential class members at a given time, what each and every class member was told by his broker, and what other information these potential class members received and when they received it.

The plaintiffs contend that under the reasoning in *Kennedy v. Tallant*, 710 F.2d 711, 718 (11th Cir. 1983), even if some class members are threatened with a potential statute of limitations defense, that problem would not necessarily defeat the availability of the class action suit. *Kennedy* has no bearing on this case because this court is not refusing to certify the classes simply because some class members are threatened with a potential statute of limitations defense. Rather, the court is holding that under the reasoning in *Phillips Petroleum Co. v. Shutts*, ____U.S.____, 105 S. Ct. 2965, 2980, 86 L.Ed.2d 628 (1985), and *Elster v. Alexander*, 76 F.R.D. 440, 442 (N.D. Ga. 1977), *appeal dismissed*, 608 F.2d 196 (5th Cir. 1979), individual questions of law predominate over common questions of law.

D. *State and Common Law Claims*

The final reason that individual questions of law and fact predominate over questions affecting the potential classes is that the state and common law claims – fraud and deceit, negligence and negligent misrepresentation, and fraudulent concealment and breach of fiduciary duty – require that the court apply the law of every state from which a potential class member resides. In *Sanders* the defendants' attorney indicates that his examination of client mailing lists taken from the defendants' business files shows that the defendants sold Petro-Lewis limited partnership interests to clients maintaining addresses in 32 states, the District of Columbia, and West Germany. Supplemental Affidavit of Peter J. Anderson, ¶ 3. J.C. Bradford and Paine Webber are also national brokerage houses. This court indicated in the hearing that it saw no way of managing these class actions if it had to apply the law of 50 different states, as *Phillips Petroleum Co. v. Shutts*, ____U.S.____, 105 S. Ct. 2965, 2980,

86 L.Ed.2d 628 (1985), requires. *See* Transcript of hearing February 27, 1986, at p. 115.

In *Shutts* the Supreme Court held that a court "may not take a transaction with little or no relationship to the forum and apply the law of the forum in order to satisfy the procedural requirement that there be a 'common question of law.' " *Shutts*, 105 S. Ct. at 2980. The Court rejected the Kansas Supreme Court's holding that "in a nationwide class action where procedural due process guarantees of notice and adequate representation were met, the laws of the forum should be applied unless compelling reasons exist for applying a different law." *Id.* at 2981. This court, therefore, would have no choice but to apply the law of each state in which a potential class member resides. In *Elster v. Alexander*, 76 F.R.D. 440, 442 (N.D. Ga. 1977), *appeal dismissed*, 608 F.2d 196 (5th Cir. 1979), this court held:

> Plaintiff's allegations of common law fraud raise questions of fact and law under the law of each state in which the class member made a purchase. The complaint alleges that class members reside throughout the county [*sic*]. Considering the size of the potential class to be 8,500 members, it is likely that the claim for relief based upon common law fraud would involve the laws of all 50 states. With no single law governing the entire class, the allegation of common law fraud cannot be shown to warrant class treatment. *See Simon v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 482 F.2d 880 (5th Cir. 1973); *King v. Sharp*, 63 F.R.D. 60 (N.D. Tex. 1974); *Adise v. Mather*, 56 F.R.D. 492 (D. Col. 1972).

This court is bound by the decision in *Simon v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 482 F.2d 880, 883 (5th Cir. 1973), in which the court held:

> [T]he geographic dispersion of the alleged representations would bring into issue various state common law standards. With no single law governing the

entire class, common issues of law cannot be shown to warrant Rule 23 treatment.

Numerous courts have followed the reasoning in *Simon* and *Elster. See, e.g., Zandman v. Joseph*, 102 F.R.D. 924, 929 (N.D. Ind. 1984) (holding that "common issues would not predominate in that the fraud issues would have to be tried in accordance with the substantive law of the state of each class member."); *Coca-Cola Bottling Co. v. Coca-Cola Co.*, 95 F.R.D. 168, 177-78 (D. Del. 1982) (refusing to certify class action because it would involve applying the law of more than one state); *Seiden v. Nicholson*, 69 F.R.D. 681, 686 (N.D. Ill. 1976) ("Obviously, a common law fraud claim raises issues which are personal to each individual plaintiff and, therefore, not common to the class. Since individual issues predominate on common law fraud claims, . . . these claims should not be certified for class determination."); *In re U.S. Financial Securities Litigation*, 64 F.R.D. 443, 455 (S.D. Cal. 1974) ("The common law fraud claims brought under pendent jurisdiction are also inappropriate because individual questions of law would predominate if it were necessary to canvass the law of every state in which a purchase of debentures was made."). [16]

The plaintiffs contend that the elements of a fraud claim in each state are basically the same. For this reason, they assert, the court would have no difficulty applying the law of each of the 50 states. While this court does not intend to survey the law of fraud in all 50 states, several major differences do exist. For example, in Alabama a plaintiff does not need to prove that the defendant knew that his representation was false or that he intended to make a false representation, *see Fountain-Lowery Enterprises v. Williams*, 424 So.2d 581, 585 (Ala. 1982), while in Florida the defendant must knowingly and purposefully make a false statement, *see Osborne v. Delta Maintenance and*

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[16] Several courts have certified class actions that include common law fraud claims. *See, e.g., Steiner v. Equimark Corp.*, 96 F.R.D. 603, 606 (W.D. Pa. 1983); *Dekro v. Stern Bros. & Co.*, 540 F. Supp. 406, 418 (W.D. Mo. 1982). This court does not agree with and is not bound by the reasoning in these decisions.

Welding, Inc., 365 So.2d 425, 427 (Fla. App. 1978). In Mississippi, Ohio, South Carolina, and Tennessee, a plaintiff must prove that he had the right to rely on the defendant's representations, *see, e.g., Dunn Appraisal Co. v. Honeywell Information Systems*, Inc., 687 F.2d 877, 882 (6th Cir. 1982) (Ohio); *Miller v. Premier Corp.*, 608 F.2d 973, 980 (4th Cir. 1979) (South Carolina); *Edwards v. Travelers Insurance of Hartford, Connecticut*, 563 F.2d 105, 113 (6th Cir. 1977) (Tennessee); *Franklin v. Lovitt Equipment Co.*, 420 So.2d 1370, 1373 (Miss. 1982), while in other states the plaintiff does not need to prove that he had the right to rely on the defendant's statements, *see, e.g., Keck v. Wacker*, 413 F. Supp. 1377, 1383 (E.D. Ky. 1976); *Stone v. Lawyers Title Insurance Corp.*, 554 S.W.2d 183, 185 (Tex. 1977); *Jefferson Standard Life Insurance Co. Hendrick*, 27 S.E.2d 198, 202 (Va. 1943).

A third area in which the requirements of the various states differ in fraud actions is that the element of scienter varies from state to state. Kentucky, Ohio, and Texas require knowledge of falsity or reckless disregard for the truth. *See Dunn Appraisal Co. v. Honeywell Information Systems, Inc.*, 687 F.2d 877, 882 (6th Cir. 1982); *Keck v. Wacker*, 413 F. Supp. 1377, 1383 (E.D. Ky. 1976); *Stone v. Lawyers Title Insurance Corp.*, 554 S.W.2d 183, 185 (Tex. 1977). Georgia and North Carolina require that the defendant knew the representations were false. *See Grant v. Aulicky*, 161 Ga. App. 817, 819, 290 S.E.2d 107, 109 (1982); *Stone v. Martin*, 56 N.C.App. 473, 289 S.E.2d 898, 901-02 (N.C. App. 1982). In Virginia intention is immaterial, *Ware v. Scott*, 220 Va. 317, 257 S.E.2d 855, 857 n.2 (1979), while in Tennessee and South Carolina intention is a necessary element of a fraud action. *See Cumberland Portland Cement Co. v. R.F.C.*, 140 F. Supp. 739, 750 (E.D. Tenn. 1953); *Lancaster v. Smithco., Inc.*, 238 S.C. 15, 119 S.E.2d 145, 145 (1961). In Louisiana, the intention must be either to obtain an unjust advantage for one party or to cause loss or inconvenience to the other. La. Civ. Code Ann. art. 1953 (West 1986).

This brief survey of the law of fraud indicates that this court would have to analyze and interpret the laws of each state

for all three state and common law claims. More importantly, a jury would have to receive a new set of instructions and apply a different standard of law for each state in which a potential class member resides. Clearly, individual questions of law and fact predominate over common questions for these pendent claims.

VI. SUMMARY

In summary, because the plaintiffs have failed to meet the requirements of Rule 23(a)(4) and Rule 23(b)(3), the motions for class certification are DENIED. The plaintiffs may proceed individually against the defendants but may not represent the proposed classes. Pursuant to Rule 23(d)(4), the court ORDERS that the pleadings be amended to strike all references to class action and the representation of absent individuals.

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

GLENN T. SANDERS, on behalf of himself and all others similarly situated,

Plaintiffs,

vs.

ROBINSON HUMPHREY/AMERICAN EXPRESS, INC., *et al.*,

Defendants.

CIVIL ACTION
No. C 85-172 A

Opinion of VINING, District Judge.

ORDER

In this action for violation of the federal securities laws and for state law fraud, deceit, and negligent misrepresentation, the defendants have moved to dismiss the complaint pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure.

On January 25, 1985, the plaintiff filed a class action complaint alleging violations of, *inter alia*, sections 11, 12, and 15 of the Securities Act of 1933 (the Securities Act), 15 U.S.C. §§ 77k, 77*l*, and 77o, section 10 of the Securities Exchange Act of 1934 (the Exchange Act), 15 U.S.C. § 78j(b), and Rule 10b-5 promulgated thereunder, and state law, arising out of the defendants' sale of limited partnerships.

Shearson Lehman is a major national brokerage firm that is licensed to do business in Georgia and maintains branch offices in Atlanta. Robinson Humphrey is a regional brokerage firm operated in the southeastern United States, with its principal place of business in Atlanta, Georgia. On or about June 6, 1982, Shearson Lehman acquired Robinson Humphrey. Defendants Martin, Sands, and Asher were the principal officers of Robinson Humphrey, and defendants Weill and Cohen were the principal officers of Shearson Lehman during the time period in question.

On three separate occasions, the plaintiff purchased limited partnership interests, through Robinson Humphrey, in Petro-Lewis partnership programs. From 1970 to 1983, Petro-Lewis was the nation's largest seller of oil and gas income funds. Petro-Lewis, an independent oil and gas producer and manager of petroleum investments for public and private partners, acquired oil and gas properties for public limited partnerships, shared ownership of those properties, and managed the limited partnerships as general partner. Over a fourteen year period, Petro-Lewis sold, through securities brokerage firms, in excess of $3 billion worth of partnerships. On May 14, 1981, the plaintiff invested $25,000 in a Petro-Lewis oil income program. On August 17, 1981, the plaintiff invested an additional $25,000 in Petro-Lewis' one time deferred income program. On October 6, 1982, the plaintiff invested $150,000 in another Petro-Lewis oil income program. The plaintiff purchased each of these programs from Robinson Humphrey. When the value of these programs began to weaken, the plaintiff sued Petro-Lewis under various provisions of the Exchange Act and the Securities Act, alleging that prospectuses issues by Petro-Lewis were false and misleading. *See In re Petro-Lewis Securities Litigation*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 91,899 (D. Colo. 1984). Petro-Lewis settled the resulting class action lawsuits by establishing a royalty trust.

The plaintiff then brought this action against the defendants. On May 1, 1985, the defendants filed a motion to dismiss the complaint for three reasons: (i) the plaintiff's section 11, 12, and 15 claims under the Securities Act are barred by the applicable statute of limitations; (ii) the plaintiff's section 10(b) and Rule 10b-5 claims under the Exchange Act and the state law claims must be dismissed because they are not pled with the requisite particularity required by Rule 9(b) of the Federal Rules of Civil Procedure; and (iii) the state law claims are subject to dismissal because in the absence of any viable federal claim the plaintiff has failed to establish a proper basis for the court to exercise pendent jurisdiction over these claims.

I. STANDARD OF REVIEW

In a motion to dismiss for failure to state a claim under Rule 12(b)(6), a complaint should not be dismissed unless it appears beyond doubt that the plaintiff can prove no set of facts that would entitle him to relief. *Conley v. Gibson*, 355 U.S. 41, 45-46, 78 S. Ct. 99, 102, 2 L.Ed.2d 80 (1957). The allegations in the complaint and all reasonable inferences from the facts alleged must be taken as true. *See Cruz v. Beto*, 405 U.S. 319, 322, 92 S. Ct. 1079, 1081, 31 L.Ed.2d 263 (1972). Thus, the movant has a very high burden in cases under Rule 12(b)(6). Each of the defendants' arguments for dismissing the complaint is considered in turn.

II. STATUTE OF LIMITATIONS

The defendants first contend that the plaintiff's section 11, 12, and 15 claims under the Securities Act are barred by the applicable statute of limitations. Section 13, 15 U.S.C. § 77m,[1] provides the limitations period for claims brought pursuant to section 11, 15 U.S.C. § 77k, and section 12(2), 15 U.S.C. § 77(*l*)(2), of the Securities Act.[2] Section 13 is a two-pronged statute of limitations.

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[1] Section 13 provides:

> No action shall be maintained to enforce any liability created under section 77k or 77*l*(2) of this title unless brought within one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence, . . . In no event shall any such action be brought to enforce a liability created under section 77k or 77*l*(1) of this title more than three years after the security was bona fide offered to the public, or under 77*l*(2) of this title more than three years after the sale.

[2] Section 15, 15 U.S.C. § 77o, is the "controlling person" liability provisions for sections 11 and 12. A claim against a controlling person is governed by the same limitations period that applies to the Securities Act claim against the controlled person. Section 13, therefore, also applies to the plaintiff's section 15 claim. *See Herm v. Stafford*, 663 F.2d 669, 679 (6th Cir. 1981).

A. Section 13 One-Year Statute of Limitations

The one-year statute of limitations in Section 13 requires that any claim under Section 11 or 12(2) be brought within one year after the violation is discovered or should have been discovered. In the Complaint, the plaintiff referred to a *Wall Street Journal* article on April 5, 1983, that set forth in detail Petro-Lewis' financial difficulties, which the plaintiff alleges that the defendants failed to disclose to the public. Complaint ¶ 24. The defendants contend that this article placed the plaintiff on inquiry notice and began the running of the statute of limitations. Because the plaitiff did not commence this action until January 25, 1985, the defendants contend that the statute of limitations had expired. On April 8, 1983, however, Petro-Lewis issued a press release directed to shareholders and investors denying substantially all of the facts reported in the *Wall Street Journal* article. Complaint ¶ 25. In the complaint the plaintiff lists and quotes from information that he received from Petro-Lewis that would lead the reasonable investor to believe that Petro-Lewis was still financially sound and that the *Journal* article was inaccurate. Complaint ¶¶ 26-35.

The complaint alleges that it was not until February 6, 1984, that Petro-Lewis revealed that it was experiencing extreme financial difficulties. Complaint ¶ 35. The allegations in the complaint and all reasonable inferences from the facts alleged must be taken as true. *Cruz v. Beto*, 405 U.S. 319, 322, 92 S. Ct. 1079, 1081, 31 L.Ed.2d 263 (1972). Because the plaintiff filed this action on January 25, 1985, he is within the one-year statute of limitations.

B. Section 13 Three-Year Statute of Limitations

The section 13 statute of limitations has slightly different provisions for section 11 and section 12(2). For section 11, the statute provides, "In no event shall any such action be brought to enforce a liability created under section 77k [section 11] . . . of this title more than three years after the security was bona fide offered to the public . . . ." The plaintiff does not dispute that his purchases of Petro-Lewis limited partnership interests in May and August 1981 are time-barred for failure to comply with

section 13. Clearly these securities were first offered to the public more than three years prior to the commencement of this action in January 1985. The plaintiff made his third purchase of Petro-Lewis limited partnership interests on October 6, 1982, pursuant to a prospectus dated June 21, 1982. The plaintiff, therefore, has satisfied the requirement of bringing his section 11 claim within three years of the date of the initial offering of the 1982 securities.

The section 13 statute of limitations for section 12(2) provides: "[I]n no event shall any such action be brought to enforce a liability created under . . . section 77*l*(2) [section 12(2)] of this title more than three years after the sale." The three-year limitation period that applies to section 12(2) differs from the limitation period for section 11 in one respect only; the three-year absolute time bar for section 12(2) begins to run on the date the securities were sold, not when they were bona fide offered to the public. As discussed above, the plaintiff's third purchase of securities on October 6, 1982, was clearly within the three-year statute of limitations period.

The plaintiff also contends that, based on the "integrated offering" theory, his purchases of securities in May and August 1981 fall within the three-year statutory period. The court does not find this argument persuasive.

The integrated offering theory was developed to determine whether an offering qualifies for a particular exemption. The Securities and Exchange Commission established a five-part test to determine whether the nonpublic offering exemption, section 4(2) of the Securities Act, applies in questions about integrated offerings. *See* FED. SEC. REP. ¶ 2781 (1982); *Securities and Exchange Commission v. Murphy*, 626 F.2d 633, 645 (9th Cir. 1980). In an offering is "integrated," it may have to be registered. This court can find no cases in which courts have used the five-part test as a means of getting around the statute of limitations in section 13. In *Murphy*, for example, the court used the test in considering whether to apply the private offering exemption. The case did not concern, and the courts did not address, the statute of limitations.

The court also was unable to find any reported cases holding that the integrated offering doctrine applies to a claim arising out of sections 11, 12(2), or 15 of the Securities Act. Courts, however, have used this theory to consider claims under section 10(b) of the Exhcange Act and Rule 10b-5 promulgated thereunder. *See, e.g., Currie v. Cayman Resources Corp.*, 595 F. Supp. 1364 (N.D. Ga. 1984). The plaintiff incorrectly suggests that in *Currie* the court applied the integrated offering doctrine to sustain a section 12(2) claim that was otherwise time-barred. In fact, in *Currie* the court restricted its analysis of the integrated offering doctrine to the plaintiff's claim arising under section 10(b) and Rule 10b-5.

Section 10(b) and Rule 10b-5 of the Exchange Act and section 12(2) of the Securities Act are different provisions. For example, Rule 10b-5 requires scienter; section 12(2) does not. Rule 10b-5 applies to any purchase or sale by any person; under section 12(2) a purchaser can sue only the person from whom he bought the security. There is no specific statute of limitations governing timeliness of actions brought for violation of section 10(b) or Rule 10b-5. *See Diamond v. Lamotte*, 709 F.2d 1419, 1421 (11th Cir. 1983). On the other hand, section 13 is the statute of limitations for section 12(2) of the Securities Act. The integrated offering doctrine does not concern the running of the statute of limitations for purposes of section 12(2). *See Homburger v. Venture Minerals, Inc.*, [1982 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 98,858 at 94,426 n.3 (S.D.N.Y. 1982).

C. Failure to Plead Compliance with Section 13

The defendant also argues that the court should dismiss the section 11 and 12(2) claims because the plaintiff failed to plead compliance with the section 13 statute of limitations. This court holds that it is not necessary to plead compliance with the statute *in haec verba*; the plaintiff must merely plead and prove facts sufficient to demonstrate compliance with the statute of limitations. *See Eriksson v. Galvin*, 484 F. Supp. 1108, 1118 (S.D. N.Y. 1980); *Brick v. Dominion Mortgage and Realty Trust*, 442 F. Supp. 283, 291 (W.D. N.Y. 1977); 3 L. Loss, Securities Regulation 1744 (2d ed. 1961). In *Currie v. Cayman Resources Corp.*,

595 F. Supp. 1364, 1377 (N.D. Ga. 1984), the court held that compliance with section 13 "must be pleaded as a substantive element of the plaintiff's Securities Act claims." To the extent that *Currie* may be read to require pleading compliance with section 13 *in haec verba*, this court declines to follow that decision. Any other result would elevate form over substance and require dismissal of the plaintiff's section 11 and 12(2) claims based on a mere technicality. Moreover, nothing in the Securities Act dictates that a plaintiff plead compliance with the statute of limitations as a substantive element of his cause of action.

D. Aiding and Abetting Under Section 11

In paragraph 15 of the complaint, the plaintiff alleges aiding and abetting liability under section 11. There is no cause of action for aiding and abetting a section 11 violation. *See In re Flight Transportation Corp. Securities Litigation*, 593 F. Supp. 612, 616 (D. Minn. 1984); *Hagert v. Glickman, Lurie, Eiger & Co.*, 520 F. Supp. 1028, 1034 (D. Minn. 1981); *McFarland v. Memorex Corp.*, 493 F. Supp. 631, 642 (N.D. Cal. 1980); *In re Equity Funding Corp. of America Securities Litigation*, 416 F. Supp. 161, 181 (C.D. Cal. 1976). Based on this authority, paragraph 50 of the complaint is dismissed.

III. FRAUD

The defendants' second ground for dismissing this action is that the plaintiff's claims under section 10(b) of the Exchange Act[3] and Rule 10b-5 promulgated thereunder and his state law

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[3] Section 10(b) of the Exchange Act provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange –

(b) To use or employ, in connection with the purchase or sale of any security registered on a national security exchange or any security not so registered, any manipulative or deceptive device or contrivance in

(footnote continued)

claims[4] for common law fraud and deceit, fraudulent concealment, and breach of fiduciary duty do not adhere to the particularity requirements of Rule 9(b) of the Federal Rules of Civil Procedure. Rule 9(b) requires that in all averments of fraud "the circumstances constituting fraud . . . shall be stated with particularity." For the reasons discussed in full below, the court holds that the plaintiff has pled fraud with sufficient particularity to satisfy the requirements of Rule 9(b).

Rule 9(b) requires the pleader to include all the elements of fraud and to specifically aver the circumstances constituting fraud. This Rule applies to securities transactions, generally requiring inclusion of the "time, place, and content of the . . . misrepresentations, the facts misrepresented, and the nature of the detrimental reliance, with some leniency allowed for complex issues or transactions covering a long period of time." *Currie v. Cayman Resources Corp.*, 595 F. Supp. 1364, 1371 (N.D. Ga. 1984); *see Elster v. Alexander*, 75 F.R.D. 458, 461 (N.D. Ga. 1977).

The plaintiff's detailed 40-page complaint, citation to financial information and advice prepared by the defendants, and references to particular misrepresentations and omissions indicate that the plaintiff's complaint is more than mere vague conclusory allegations. The complaint alleges the role of the individual and corporate defendants in preparing and disseminating the false and misleading material to the investing public and describes other circumstances constituting the defendants' scheme to defraud. Rule 9(b) does not require the pleading

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contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. 78j.

[4] Rule 9(b) applies to the state law fraud claims as well as to the federal securities claims because the Rule applies to all averments of fraud. *See Currie*, 595 F. Supp. at 1373.

of detailed evidentiary matter. 2A J. Moore & J. Lucas, Moore's Federal Practice ¶ 9.03 (2d ed. 1984); *see Currie*, 595 F. Supp. at 1371.

In fraudulent concealment cases the facts are often difficult for the plaintiff to discover at this early stage of the litigation. In this action, the defendants have access to information that the plaintiff could not acquire prior to filing the complaint. Nevertheless, the complaint identifies the documents alleged to be false and misleading, quotes specific excerpts from those documents, and cites from where the excerpts were taken. The complaint also describes the manner in which each of these statements is alleged to be false or misleading, identifies the persons and entities responsible for the preparation and dissemination of the documents, and sets forth either the exact or approximate date when each document was issued. These assertions, taken together, fairly apprise the defendants of the transactions complained of, and satisfy Rule 9(b). *Dudley v. Southeastern Factor and Finance Corp.*, 446 F.2d 303, 308 n.6 (5th Cir.), *cert. denied*, 404 U.S. 858, 92 S. Ct. 109 (1971). The Federal Rules of Civil Procedure do not require a claim to set out in detail the facts upon which he bases his claim. "To the contrary, all the Rules require is a 'short and plain statement of the claim' that will give the defendant fair notice of what the plaintiff's claim is and the grounds upon which it rests." *Conley v. Gibson*, 355 U.S. 41, 47, 78 S. Ct. 99, 103 (1957) (quoting Rule 8(a)).

The plaintiff alleges that the defendants are liable under section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder. The basic elements of a cause of action under Rule 10b-5 are:

> (1) Defendants used the mails, or an instrumentality of interstate commerce, in connection with the purchase or sale of a security;
>
> (2) That in connection with the purchase or sale, defendants employed a device, scheme, or artifice to defraud, or made an untrue statement of a material fact, or omitted to state a material fact necessary in

order to make the statements in light of the circumstances under which they were made not misleading, or engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person;

(3) That the defendants have the requisite "scienter";

(4) That the plaintiff relied on the statements of defendant; and

(5) That plaintiff suffered damages as a result.

Currie, 595 F. Supp. at 1372, quoting *Rosenbloom v. Adams, Scott & Conway, Inc.*, 521 F. Supp. 372, 379 (S.D. N.Y. 1981); *see Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193, 96 S. Ct. 1375, 1380, 47 L.Ed.2d 668 (1976).

First, the plaintiff alleges that the defendants used the instrumentalities of interstate commerce and of the mails. *See* Complaint ¶ 72. Second, the plaintiff contends that the defendants made misrepresentations or omissions designed to operate as a fraud or deceit upon the plaintiff. *See* Complaint ¶ 67-70. Third, the plaintiff asserts that the defendants acted with the requisite scienter. *See* Complaint ¶ 68-69. Fourth, the plaintiff indicates that he relied on the defendants' statements. *See* Complaint ¶ 71. Finally, the plaintiff alleges that he was damaged by the defendants' actions. *See* Complaint ¶ 73. The plaintiff, therefore, has adequately set forth the elements of a cause of action under Rule 10b-5.

For the reasons discussed above, the court also holds that the plaintiff's state law claims meet the particularity requirements of Rule 9(b) of the Federal Rules of Civil Procedure.

IV. THE STATE LAW CLAIMS

The defendants' final argument in the motion to dismiss is that the court should dismiss the plaintiff's state law claims

because the court does not have subject matter jurisdiction over them. The sole basis for inclusion of these claims in this federal action is pendent jurisdiction. Complaint ¶ 2. Because the federal law claims survive the defendants' motion to dismiss, the court will also exercise jurisdiction over the state law claims under the principles of pendent jurisdiction. *United Mine Workers of America v. Gibbs*, 383 U.S. 715, 721-29, 86 S. Ct. 1130 (1966).

V. SUMMARY

The defendants' motion to dismiss is GRANTED with respect to the plaintiff's sections 11 and 12(2) claims for his 1981 purchases; in all other respects the motion is DENIED.

Dated: September 11, 1985

IN THE UNITED STATES COURT OF APPEALS

FOR THE ELEVENTH CIRCUIT

No. 86-2085

U.S. COURT OF APPEALS ELEVENTH CIRCUIT
FILED AUG 21 1986, MIGUEL J. CORTEZ, CLERK

GLENN T. SANDERS and
LESLIE D. SANDERS,

Petitioners,

versus

ROBINSON-HUMPHREY/AMERICAN EXPRESS, INC., and SHEARSON/AMERICAN EXPRESS, INC.,

Respondents.

- - - - - - - - -

Application for Permission to Appeal from the United States District Court for the Northern District of Georgia

- - - - - - - - -

Before HILL, KRAVITCH and FAY, Circuit Judges.

BY THE COURT:

The petition for permission to appeal pursuant to 28-U.S.C. § 1292(b) is granted.

UNITED STATES COURT OF APPEALS
Eleventh Circuit
56 Forsyth Street, N.W.
Atlanta, Georgia 30303
October 21, 1987

Miguel J. Cortez
Clerk

In Replying Give Number
Of Case and Names Of Parties

MEMORANDUM TO COUNSEL OR PARTIES LISTED BELOW:

NOS. 86-8624, 86-8625 & 86-8626
SUZANNE KIRKPATRICK, et al. v. J.C. BRADFORD & CO.
(Nos. C85-1891A, C85-172A & C85-1586A)

The enclosed order has been entered on petition(s) for rehearing.

See Rule 41, Federal Rules of Appellate Procedure, and Eleventh Circuit Rule 41-1 for information regarding issuance and stay of mandate.

Sincerely,

MIGUEL J. CORTEZ, Clerk

By: /s/ Pam Holloway
Deputy Clerk

Encl.

Brenda M. Nelson
Kenneth A. Jacobsen
Richard D. Greenfield
Richard M. Kirby
Robert E. Zimet
Glenn Delk
Ames Davis
Robert E. Boston
Lloyd S. Clareman
Harvey D. Myerson
Bradley C. Twedt
Timothy J. Carey
Peter J. Anderson
Mack Young

IN THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

No. 86-8624

SUZANNE KIRKPATRICK;
DOROTHY D. CASLER and
CHARLES H. LINDSEY, on
behalf of themselves and
all others similarly situated,

Plaintiffs-Appellants,

versus

J.C. BRADFORD & CO.,

Defendant-Appellee.

No. 86-8625

GLENN T. SANDERS on behalf
of himself and all others
similarly situated, and
LESLIE D. SANDERS,

Plaintiffs-Appellants,

versus

ROBINSON HUMPHREY/AMERICAN
EXPRESS, INC., and SHEARSON/AMERICAN
EXPRESS, INC.,

Defendants-Appellees.

NO. 86-8626

TOMMY E. PARKER, as custodian
for KIMBERLY M. PARKER and JAMES L.
SMITH, on behalf of themselves and
all others similarly situated,

Plaintiffs-Appellants,

versus

PAINE WEBBER GROUP, INC.,

Defendant-Appellee.

Appeals from the United States District Court for the
Northern District of Georgia

ON PETITION(S) FOR REHEARING AND SUGGESTION(S)
OF REHEARING IN BANC

(Opinion September 15, 11 Cir., 1987, ____ F.2d ____).
(October 21, 1987)

Before VANCE and KRAVITCH, Circuit Judges, and BROWN*,
Senior Circuit Judge.
PER CURIAM:

(×) The Petition(s) for Rehearing are DENIED and no member of this panel nor other Judge in regular active service on the Court having requested that the Court be polled on rehearing in banc (Rule 35, Federal Rules of Appellate Procedure; Eleventh Circuit Rule 35-5), the Suggestion(s) of Rehearing In Banc are DENIED.

( ) The Petition(s) for Rehearing are DENIED and the Court having been polled at the request of one of the members of the Court and a majority of the Circuit Judges who are in regular active service not having voted in favor of it (Rule 35, Federal

Rules of Appellate Procedure; Eleventh Circuit Rule 35-5), the Suggestion(s) of Rehearing In Banc are also DENIED.

( ) A member of the Court in active service having requested a poll on the reconsideration of this cause in banc, and a majority of the judges in active service not having voted in favor of it, Rehearing In Banc is DENIED.

ENTERED FOR THE COURT:

/s/ Phyllis Kravitch

United States Circuit Judge

* Honorable John R. Brown, Senior U.S. Circuit Judge for the Fifth Circuit, sitting by designation.

UNITED STATES COURT OF APPEALS
Eleventh Circuit
56 Forsyth Street, N.W.
Atlanta, Georgia 30303

Miguel J. Cortez
Clerk

In Replying Give Number
Of Case And Names Of Parties

November 17, 1987

TO: ALL COUNSEL LISTED BELOW:

No. 86-8624, 86-8625 & 86-8626
KIRKPATRICK, et al. v. BRADFORD, et al.

MANDATE STAYED TO AND INCLUDING November 23, 1987.

The court has this day granted a stay of the mandate to the date shown above. If during the period of the stay there is filed in this court a notice from the Clerk of the Supreme Court that the party who has obtained the stay has filed a petition for writ of certiorari in the Supreme Court, the stay shall continue until final disposition by the Supreme Court. Upon the filing of a copy of an order of the Supreme Court denying the petition for writ of certiorari, the mandate shall issue forthwith. See Fed.R.App.P. 41.

The Clerk of the Supreme Court has requested the clerks of the federal courts of appeal to retain the record on appeal until the Supreme Court requests that it be transmitted. Parties will be advised when this occurs. Accordingly, please refrain from routinely requesting transmittal of the record. See Supreme Court Rule 19.1.

A copy of this court's opinion (or Rule 36-1 decision), the judgment, and any order on rehearing should be attached as an appendix to any petition for writ of certiorari (or jurisdictional statement) filed. See Supreme Court Rules 21(k), 15(j).

( ) This court has also directed recall of the mandate. By copy of this letter the clerk of the district court is requested to return the opinion and judgment previously issued as mandate.

Sincerely,

MIGUEL J. CORTEZ, Clerk

By: /s/ Pam Holloway
Deputy Clerk

Glenn Delk
Kenneth A. Jacobsen
Richard D. Greenfield
Ames Davis
Robert E. Boston
Lloyd S. Clareman
Harvey D. Myerson
Bradley C. Twedt
Timothy J. Carey
Peter J. Anderson
Mack Young
Brenda M. Nelson
Richard M. Kirby
Robert E. Zimet

IN THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

No. 86-8624

SUZANNE KIRKPATRICK;
DOROTHY D. CASLER and
CHARLES H. LINDSEY, on
behalf of themselves and
all others similarly situated,

Plaintiffs-Appellants,

versus

J.C. BRADFORD & CO.,

Defendant-Appellee.

No. 86-8625

GLENN T. SANDERS on behalf
of himself and all others
similarly situated, and
LESLIE D. SANDERS,

Plaintiffs-Appellants,

versus

ROBINSON HUMPHREY/AMERICAN
EXPRESS, INC., and SHEARSON/AMERICAN
EXPRESS, INC.,

Defendants-Appellees.

No. 86-8626

TOMMY E. PARKER, as custodian for KIMBERLY M. PARKER and JAMES L. SMITH, on behalf of themselves and all others similarly situated,

Plaintiffs-Appellants,

versus

PAINE WEBBER GROUP, INC.,

Defendant-Appellee,

FILED
U.S. COURT OF APPEALS
ELEVENTH CIRCUIT
NOV 17
MIGUEL J. CORTEZ, CLERK

Appeal from the United States District Court for the Northern District of Georgia

ORDER:

( ) The motion of Appellees, J.C. BRADFORD & CO., et al. for (xx) stay ( ) recall and stay of the issuance of the mandate pending petition for writ of certiorari is DENIED.

(x) The motion of Appellees, J.C. BRADFORD & CO., et al. for (xx) stay ( ) recall and stay of the issuance of the mandate pending petition for writ of certiorari is GRANTED to and including Nov. 23rd 1987, the stay to continue in force until the final disposition of the case by the Supreme Court, provided that within the period above mentioned there shall be filed wtih the Clerk of this Court the

certificate of the Clerk of the Supreme Court that the certiorari petition has been filed. The Clerk shall issue the mandate upon the filing of a copy of an order of the Supreme Court denying the writ, or upon expiration of the stay granted herein, unless the above mentioned certificate shall be filed with the Clerk of this Court within that time.

( ) The motion of _____ for a further stay of the issuance of the mandate is GRANTED to and including _____, under the same conditions as set forth in the preceding paragraph.

( ) IT IS ORDERED that the motion of _____ for a further stay of the issuance of the mandate is DENIED.

/s/ Phyllis Kravitch
UNITED STATES CIRCUIT JUDGE

STATUTORY AND REGULATORY PROVISIONS INVOLVED

Section 10(b) of the Securities Exchange Act of 1934, Title 15, United States Code

§ 78j. Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Securities and Exchange Commission Rule 10b-5, Title 17, Code of Federal Regulations

§ 240.10b-5 Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Section 11 of the Securities Act of 1933, Title 15, United States Code

§ 77k. Civil liabilities on account of false registration statement

Persons possessing cause of action; persons liable

(a) In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may, either at law or in equity, in any court of competent jurisdiction, sue—

(1) every person who signed the registration statement;

(2) every person who was a director of (or person performing similar functions) or partner in the issuer at the time of the filing of the part of the registration statement with respect to which his liability is asserted;

(3) every person who, with his consent, is named in the registration statement as being or about to become a director, person performing similar functions, or partner;

(4) every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him, who has with his consent been named as having prepared or certified any part of the registration statement, or as having prepared or certified any report or valuation which is used in connection with the registration statement, with respect to the statement in such registration statement, report, or valuation, which purports to have been prepared or certified by him;

(5) every underwriter with respect to such security.

If such person acquired the security after the issuer has made generally available to its security holders an earning statement covering a period of at least twelve months beginning after the effective date of the registration statement, then the right of

recovery under this subsection shall be conditioned on proof that such person acquired the security relying upon such untrue statement in the registration statement or relying upon the registration statement and not knowing of such omission, but such reliance may be established without proof of the reading of the registration statement by such person.

Persons exempt from liability upon proof of issues

(b) Notwithstanding the provisions of subsection (a) of this section no person, other than the issuer, shall be liable as provided therein who shall sustain the burden of proof—

(1) that before the effective date of the part of the registration statement with respect to which his liability is asserted (A) he had resigned from or had taken such steps as are permitted by law to resign from, or ceased or refused to act in, every office, capacity, or relationship in which he was described in the registration statement as acting or agreeing to act, and (B) he had advised the Commission and the issuer in writing that he had taken such action and that he would not be responsible for such part of the registration statement; or

(2) that if such part of the registration statement became effective without his knowledge, upon becoming aware of such fact he forthwith acted and advised the Commission, in accordance with paragraph (1) of this subsection, and, in addition, gave reasonable public notice that such part of the registration statement had become effective without his knowledge; or

(3) that (A) as regards any part of the registration statement not purporting to be made on the authority of an expert, and not purporting to be a copy of or extract from a report or valuation of an expert, and not purporting to be made on the authority of a public official document or statement, he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the

statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading; and (B) as regards any part of the registration statement purporting to be made upon his authority as an expert or purporting to be a copy of or extract from a report or valuation of himself as an expert, (i) he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or (ii) such part of the registration statement did not fairly represent his statement as an expert or was not a fair copy of or extract from his report or valuation as an expert; and (C) as regards any part of the registration statement purporting to be made on the authority of an expert (other than himself) or purporting to be a copy of or extract from a report or valuation of an expert (other than himself), he had no reasonable ground to believe and did not believe, at the time such part of the registration statement became effective, that the statements therein were untrue or that there was an omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or that such part of the registration statement did not fairly represent the statement of the expert or was not a fair copy of or extract from the report or valuation of the expert; and (D) as regards any part of the registration statement purporting to be a statement made by an official person or purporting to be a copy of or extract from a public official document, he had no reasonable ground to believe and did not believe, at the time such part of the registration statement became effective, that the statements therein were untrue, or that there was an omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or that such part of the registration statement did not fairly represent the statement made by the official person or was not a fair copy of or extract from the public official document.

Standard of reasonableness

(c) In determining, for the purpose of paragraph (3) of subsection (b) of this section, what constitutes reasonable investigation and reasonable ground for belief, the standard of reasonableness shall be that required of a prudent man in the management of his own property.

Effective date of registration statement with regard to underwriters

(d) If any person becomes an underwriter with respect to the security after the part of the registration statement with respect to which his liability is asserted has become effective, then for the purposes of paragraph (3) of subsection (b) of this section such part of the registration statement shall be considered as having become effective with respect to such person as of the time when he became an underwriter.

Measure of damages; undertaking for payment of costs

(e) The suit authorized under subsection (a) of this section may be to recover such damages as shall represent the difference between the amount paid from the security (not exceeding the price at which the security was offered to the public) and (1) the value thereof as of the time such suit was brought, or (2) the price at which such security shall have been disposed of in the market before suit, or (3) the price at which such security shall have been disposed of after suit but before judgment if such damages shall be less than the damages representing the difference between the amount paid for the security (not exceeding the price at which the security was offered to the public) and the value thereof as of the time such suit was brought: *Provided*, That if the defendant proves that any portion or all of such damages represents other than the depreciation in value of such security resulting from such part of the registration statement, with respect to which his liability is asserted, not being true or omitting to state a material fact required to be stated therein or necessary to make the statements therein not misleading, such portion of or all such damages shall not be recoverable. In no event shall any underwriter (unless such underwriter shall have knowingly received

from the issuer for acting as an underwriter some benefit, directly or indirectly, in which all other underwriters similarly situated did not share in proportion to their respective interests in the underwriting) be liable in any suit or as a consequence of suits authorized under subsection (a) of this section for damages in excess of the total price at which the securities underwritten by him and distributed to the public were offered to the public. In any suit under this or any other section of this subchapter the court may, in its discretion, require an undertaking for the payment of the costs of such suit, including reasonable attorney's fees, and if judgment shall be rendered against a party litigant, upon the motion of the other party litigant, such costs may be assessed in favor of such party litigant (whether or not such undertaking has been required) if the court believes the suit or the defense to have been without merit, in an amount sufficient to reimburse him for the reasonable expenses incurred by him, in connection with such suit, such costs to be taxed in the manner usually provided for taxing of costs in the court in which the suit was heard.

Joint and several liability

(f) All or any one or more of the persons specified in subsection (a) of this section shall be jointly and severally liable, and every person who becomes liable to make any payment under this section may recover contribution as in cases of contract from any person who, if sued separately, would have been liable to make the same payment, unless the person who has become liable was, and the other was not, guilty of fraudulent misrepresentation.

Offering price to public as maximum amount recoverable

(g) In no case shall the amount recoverable under this section exceed the price at which the security was offered to the public.

Section 12(2) of the Securities Act of 1933, Title 15, United States Code

§ 77*l*. Civil liabilities arising in connection with prospectuses and communications

Any person who—

* * *

(2) offers or sells a security (whether or not exempted by the provisions of section 77c of this title, other than paragraph (2) of subsection (a) of said section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,

shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

Section 15 of the Securities Act of 1933, Title 15, United States Code

§ 77*o*. Liability of controlling persons

Every person who, by or through stock ownership, agency, or otherwise, or who, pursuant to or in connection with an agreement or understanding with one or more other persons by or through stock ownership, agency, or otherwise, controls any person liable under sections 77k or 77*l* of this title, shall also be liable jointly and severally with and to the same extent as such

controlled person to any person to whom such controlled person is liable, unless the controlling person had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist.

Rule 23 of the Federal Rules of Civil Procedure

Class Actions

(a) **Prerequisites to a Class Action.** One or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.

(b) **Class Actions Maintainable.** An action may be maintained as a class action if the prerequisites of subdivision (a) are satisfied, and in addition:

(1) the prosecution of separate actions by or against individual members of the class would create a risk of

(A) inconsistent or varying adjudications with respect to individual members of the class which would establish incompatible standards of conduct for the party opposing the class, or

(B) adjudications with respect to individual members of the class which would as a practical matter be dispositive of the interests of the other members not parties to the adjudications or substantially impair or impede their ability to protect their interests; or

(2) the party opposing the class has acted or refused to act on grounds generally applicable to the class, thereby making appropriate final injunctive relief or corresponding declaratory relief with respect to the class as a whole; or

(3) the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is

superior to other available methods for the fair and efficient adjudication of the controversy. The matters pertinent to the findings include: (A) the interest of members of the class in individually controlling the prosecution or defense of separate action; (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; (D) the difficulties likely to be encountered in the management of a class action.

(c) **Determination by Order Whether Class Action to be Maintained; Notice; Judgment; Actions Conducted Partially as Class Actions.**

(1) As soon as practicable after the commencement of an action brought as a class action, the court shall determine by order whether it is to be so maintained. An order under this subdivision may be conditional, and may be altered or amended before the decision on the merits.

(2) In any class action maintained under subdivision (b)(3), the court shall direct to the members of the class the best notice practicable under the circumstances, including individual notice to all members who can be identified through reasonable effort. The notice shall advise each member that (A) the court will exclude him from the class if he so requests by a specified date; (B) the judgment, whether favorable or not, will include all members who do not request exclusion; and (C) any member who does not request exclusion may, if he desires, enter an appearance through his counsel.

(3) The judgment in an action maintained as a class action under subdivision (b)(1) or (b)(2), whether or not favorable to the class, shall include and describe those whom the court finds to be members of the class. The judgment in an action maintained as a class action under subdivision (b)(3), whether or not favorable to the class, shall include and specify or describe those to whom the notice provided in subdivision (c)(2) was directed, and who have not requested exclusion, and whom the court finds to be members of the class.

(4) When appropriate (A) an action may be brought or maintained as a class action with respect to particular issues, or (B) a class may be divided into subclasses and each subclass treated as a class, and the provisions of this rule shall then be construed and applied accordingly.

(d) **Orders in Conduct of Actions.** In the conduct of actions to which this rule applies, the court may make appropriate orders: (1) determining the course of proceedings or prescribing measures to prevent undue repetition or complication in the presentation of evidence or argument; (2) requiring, for the protection of the members of the class or otherwise for the fair conduct of the action, that notice be given in such manner as the court may direct to some or all of the members of any step in the action, or of the proposed extent of the judgment, or of the opportunity of members to signify whether they consider the representation fair and adequate, to intervene and present claims or defenses, or otherwise to come into the action; (3) imposing conditions on the representative parties or on intervenors; (4) requiring that the pleadings be amended to eliminate therefrom allegations as to representation of absent persons, and that the action proceed accordingly; (5) dealing with similar procedural matters. The orders may be combined with an order under Rule 16, and may be altered or amended as may be desirable from time to time.

(e) **Dismissal or Compromise.** A class action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to all members of the class in such manner as the court directs.

Supreme Court, U.S.
FILED
DEC 23 1987
JOSEPH F. SPANIOL, JR.
CLERK

(2)

No. 87-835

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

ROBINSON HUMPHREY/AMERICAN EXPRESS, INC.
and SHEARSON/AMERICAN EXPRESS, INC.,
Petitioners,

VS.

GLENN T. SANDERS and LESLIE D. SANDERS,
on behalf of themselves and all others similarly situated,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

KENNETH A. JACOBSEN
Richard D. Greenfield
Nicholas E. Chimicles
GREENFIELD & CHIMICLES
One Haverford Centre
361 West Lancaster Avenue
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Glenn A. Delk*
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(404) 876-3600

*Counsel of Record for Respondents

Attorneys for Respondents

48 pp

EDITOR'S NOTE

THE FOLLOWING PAGES WERE POOR HARD COPY AT THE TIME OF FILMING. IF AND WHEN A BETTER COPY CAN BE OBTAINED, A NEW FICHE WILL BE ISSUED.

COUNTERSTATEMENT OF THE QUESTIONS PRESENTED FOR REVIEW

1. Is it appropriate for this Court to exercise its certiorari jurisdiction to review a decision of the United States Court of Appeals for the Eleventh Circuit which neither granted nor denied a motion for class certification in an action arising under the federal securities laws but, rather, remanded the matter to the District Court for further proceedings consistent with its decision?

2. Did not the Court of Appeals for the Eleventh Circuit properly conclude that the District Court, in ruling on a motion for class certification, was not permitted to disregard the allegations of respondents' Complaint and recharacterize the case in a manner which respondents neither pleaded nor intend to prove?

3. Did not the Court of Appeals for the Eleventh Circuit properly conclude that respondents were entitled to a presumption of reliance under the "fraud on the market" theory adopted by an *en banc* panel of the predecessor to that Circuit in *Shores v. Sklar,* 647 F.2d 462 (5th Cir. 1981) (*en banc*), *cert. denied,* 459 U.S. 1102 (1983)?

PARTIES TO THE PROCEEDING

The respondents in this action are Glenn T. Sanders and Leslie D. Sanders. The petitioners and their affiliates are listed in petitioners' Rule 28.1 list.

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No. 87-835

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

ROBINSON HUMPHREY/AMERICAN EXPRESS, INC. and SHEARSON/AMERICAN EXPRESS, INC.,
Petitioners,

VS.

GLENN T. SANDERS and LESLIE D. SANDERS, on behalf of themselves and all others similarly situated,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Respondents Glenn T. Sanders and Leslie D. Sanders ("respondents") respectfully request that the Court deny the Petition for a Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit (the "Petition") submitted by Robinson Humphrey/American Express, Inc. and Shearon/American Express Inc. ("petitioners") to review a judgment of the United States Court of Appeals for the Eleventh Circuit which reversed in part, affirmed in part and remanded an order of the United States District Court for the Northern District of Georgia denying respondents' motion for class certification.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Eleventh Circuit (App. Exhibit A)[1] is reported as *Kirkpatrick v. J.C. Bradford & Co.*, 827 F.2d 718 (11th Cir. 1987). The order of the Court of Appeals denying petitioners' petition for rehearing and suggestion of rehearing *en banc* is not reported and is set forth in the Appendix as Exhibit F. The order staying the mandate of the Court of Appeals is not reported and is set forth in the Appendix as Exhibit G.

The opinion of the United States District Court for the Northern District of Georgia denying respondents' motion for class certification (App. Exhibit C) is reported as *Sanders v. Robinson Humphrey/American Express, Inc.*, 634 F. Supp. 1048 (N.D. Ga. 1986). The District Court's opinion denying respondents' motion for reconsideration, granting respondents' motion to certify the case for interlocutory appeal pursuant to 28 U.S.C. § 1292(b) (1982), and staying the District Court's order denying class certification (App. Exhibit B) is reported as *Sanders v. Robinson Humphrey/American Express, Inc.*, [1986-87 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,880 (N.D. Ga. July 8, 1986).

The order of the Court of Appeals accepting the appeal pursuant to 28 U.S.C. § 1292(b) (1982) is not reported and is set forth in the Appendix as Exhibit E.

JURISDICTION

The judgment of the Court of Appeals was entered on September 15, 1987. (App. Exhibit A). Rehearing and rehearing *en banc* were denied by order dated October 21, 1987. (App. Exhibit F). The mandate of the Court of Appeals was stayed on November 17, 1987. (Appendix Exhibit G). Petitioners purport to invoke this Court's jurisdiction pursuant to 28 U.S.C. § 1254(1) (1982).

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[1] Citations herein to material printed in the Appendix appear as either "Appendix" or "(App. ____)." Such citations are to the Appendix to the Petition filed by petitioners on or about November 23, 1987.

STATUTES AND RULES INVOLVED

The statutes and rules involved in the case are Sections 11 and 12(2) of the Securities Act of 1933, 15 U.S.C. §§ 77k, 77l (2) (1982); Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1982); Securities and Exchange Commission Rule 10b-5, 17 C.F.R. § 240.10b-5 (1987); Rule 23 of the Federal Rules of Civil Procedure; and 28 U.S.C. § 1292(b) (1982). (App. Exhibit H).

COUNTERSTATEMENT OF THE CASE

General Background

The instant case represents but a small slice of the litigation arising out of the debacle involving Petro-Lewis Corporation ("Petro-Lewis" or the "Company") and brokerage firms such as petitioners which assisted Petro-Lewis in its scheme.

From 1970 through 1983, Petro-Lewis was the nation's largest seller of oil and natural gas "income funds." These programs raised money from investors, who became limited partners, and used the proceeds to purchase producing oil and gas properties. *Sanders v. Robinson Humphrey/American Express, Inc.*, 634 F. Supp. 1048, 1050 (N.D. Ga. 1986) (App. C-2).[2] Petro-Lewis and petitioners—which underwrote the sale of the partnership interests to public investors such as respondents—lured new investors to the Petro-Lewis partnership programs with enticements of stable annual returns of 12% or more earned by previous partnerships, and by the apparent liquidity provided by Petro-Lewis' pledge to repurchase any partnership interest tendered by investors. Petro-Lewis formed a new partnership each month. As soon as one monthly partnership "closed," another partnership "opened" for sale to investors. When subscriptions in an entire partnership program were sold out, a new program was immediately offered for subscription. The particular monthly partnership an investor joined was primarily a function of when his or her subscription was

[2] The Petro-Lewis partnerships conducted no drilling operations on the properties. Petitioners highlighted the elimination of the risks associated with development drilling as one of the unique safety features of Petro-Lewis' programs in the written sales literature which they distributed to public investors.

accepted and the money invested, not any choice of the investor. The average initial investment by a limited partner was $8,600. *Sanders,* 634 F. Supp. at 1050 (App. C-2).

The partnership programs were primarily income-oriented investments with only modest tax shelter features. Limited partners were paid quarterly distributions which they could either receive in cash or reinvest in new partnerships. Those who chose to reinvest their distributions received partnership interests in later partnerships. Cash distributions to the limited partners began almost immediately after each partnership was formed and were to continue for 10 to 15 years or more until the wells were depleted. Except during unusual periods of temporary cash shortages, funds to pay partnership distributions were supposed to come from profits realized from the sale of oil and gas produced by the partnership properties. *Sanders,* 634 F. Supp. at 1050 (App. C-2).

Petitioners sold the partnership interests pursuant to Sales Agreements with Petro-Lewis. In the Sales Agreements, petitioners (identified as the "Dealer") expressly warranted and represented as follows:

> By accepting this Sales Agreement, each Dealer agrees that all applications will be based and all sales of interests will be made, solely on information contained in the current prospectus. Upon request, Distributor will furnish without charge additional copies of the current prospectus in reasonable quantity.

Petitioners also represented and warranted that they would use "only the prospectus relating to [the partnership program] as it is then currently effective" in connection with the sale of any Petro-Lewis partnership interest, "and to make no offer of interests unless such offer is preceded or accompanied by such a current prospectus."

Petitioners received sales commissions of up to 7% on each partnership interest sold, plus special "sales incentive payments" when their aggregate sales exceeded a particular dollar figure. These commissions far exceeded the commissions they received on transactions involving similar types of securities. *Sanders,* 634 F. Supp. at 1052-53 (App. C-6).

As noted above, crucial to the success of this marketing scheme was the apparent steady flow of cash to the limited partners commencing almost immediately after the formation of the partnerships. Petro-Lewis and petitioners touted this "regular, reasonably predictable pattern of distributions" in prospectuses for the partnerships and in other written material distributed to prospective investors. Investors hoping to take advantage of those returns invested over $2 billion in various partnerships established between January 1981 and February 1984. *Sanders*, 634 F. Supp. at 1050-53 (App. C-2 to 8).

Unbeknownst to these investors, however, the impression of financial strength and success created by Petro-Lewis and petitioners was wholly unfounded. This impression was designed specifically to attract new investors, and to deter existing partners from exercising their redemption options. The truth was that by at least the beginning of 1981, Petro-Lewis and its partnerships were experiencing serious financial problems.

Petro-Lewis had paid premium prices for the partnership properties and had borrowed heavily from banks to help finance the acquisitions.[3] The funds to repay those loans, like the cash distributions to the partners, were supposed to come from the profits generated by the sale of oil and gas produced by the partnership properties. However, the advent of the world oil glut and attendant collapse of oil and gas prices in the early 1980's, coupled with, among other things, increased operating costs and competition from other petroleum investment programs, resulted in a severe reduction in cash flow from the partnership properties. These conditions put Petro-Lewis in a serious cash bind and jeopardized the partnership holdings. Nevertheless, in an effort to perpetuate the false impression of financial strength and to continue paying cash distributions, Petro-Lewis continued to borrow heavily from banks (thereby further encumbering the partnership properties) and shifted funds among the accounts of various affiliated companies. Meanwhile, petitioners accelerated their sales

[3] The partnership properties were used as collateral to secure the bank debt.

efforts with respect to the partnership interests. *See Sanders*, 634 F. Supp. at 1050-53 (App. C-2 to 6).

In 1984, the charade collapsed. Petro-Lewis suspended its partnership syndication operations and sold almost one-third of the oil and gas reserves held by the partnerships in order to achieve a $1 billion reduction in bank debt. Petro-Lewis also cut distributions to limited partners, imposed a cap on redemptions of partnerships, and reduced the prices at which it would repurchase those interests to a fraction of previous levels. Investors who elected to retain their partnership interests now hold, instead, units in a royalty trust, which was created as part of a complicated settlement of a securities class action against Petro-Lewis and its principal officers and directors arising out of their role in the scheme described above. *See In re Petro-Lewis Securities Litigation*, [1984-85 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,899 (D. Colo. 1984). Even taking into account the proceeds of the *Petro-Lewis* settlement, most members of the class have lost more than half of their original investment. *Sanders*, 634 F. Supp. at 1050, 1052 (App. C-2, 6).

Course Of Proceedings And Disposition In The Courts Below

On January 25, 1985, respondents filed a Class Action Complaint (the "Complaint") against petitioners for violations of the federal securities laws and common law arising out of their participation in the scheme outlined above. The Complaint asserts claims against petitioners under Sections 11 and 12(2) of the Securities Act of 1933 (the "Securities Act"), 15 U.S.C. §§ 77k and 77*l* (2), Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78j(b), Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5 (1987), and for common law fraud, fraudulent concealment, negligence and breach of fiduciary duty. The thrust of the Complaint is that petitioners violated these statutory and common law provisions: 1) by disseminating virtually identical prospectuses for the partnership programs during the class period which omitted materially adverse information concerning Petro-Lewis and its partnerships; and 2) by perpetrating a scheme and common course of conduct at the highest levels of petitioners' corporate management which had the purpose and effect of suppressing the truth about the

precarious financial condition of Petro-Lewis and its partnership programs. *Kirkpatrick v. J.C. Bradford & Co.*, 827 F.2d 718, 721 (11th Cir. 1987) (App. A-5).

Among the material information which respondents contend was omitted from the prospectuses was the following:

1. That the partnership properties were overleveraged;

2. That Petro-Lewis had engaged in a protracted pattern of bolstering cash distributions to previous partnerships by paying those distributions not from cash from operations but, rather, with borrowed funds;

3. That distributions were being inflated in order to ensure that sales in new partnerships continued;

4. That declines in the price of oil would make it impossible to adequately service the partnerships' debt and would result in forced liquidation of the partnership holdings, rendering the investments little more than a rank gamble on the price of oil;

5. That Petro-Lewis utilized improper or highly questionable accounting practices and policies; and

6. That the repurchase prices which Petro-Lewis would pay to limited partners who tendered their interests under the redemption options were extremely volatile, and that Petro-Lewis lacked sufficient funds to handle redemptions, which were coming at steadily increasing rates.[4]

The conspiracy and common course of conduct about which respondents complain is alleged to have been perpetrated at the highest levels of petitioners' corporate management. Respondents do not complain of, nor have they ever asserted any claim based upon, any oral statements made to them or any other class member by any individual employed by petitioners. *Kirkpatrick*, 827 F.2d at 721, 724 (App. A-5, 10 to 11). *See also Sanders*, 634 F. Supp. at 1053-54 (App. C-6 to 9).

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[4] Significantly, seven months after respondents filed their original Complaint in this action, the Securities and Exchange Commission ("SEC") filed a complaint against Petro-Lewis and others for alleged violations of the federal securities laws. In that action, the SEC charged that the prospectuses for the Petro-Lewis partnership programs contained the same material omissions and nondisclosures as those alleged in the Complaint in this action.

The hearing on respondents' motion for class certification took place on February 27, 1986 following briefing and discovery.[5] In its papers opposing the motion, petitioners consistently mischaracterized respondents' case to the District Court, arguing that it was one based solely on "oral misrepresentations." This self-serving characterization was reached only by totally ignoring respondents' Complaint in this case, and through a gross distortion of the record which had been developed on the class issue.

In an order dated March 27, 1986, the District Court denied respondents' motion for class certification. The District Court refused to give separate consideration to class treatment of respondents' Securities Act claims. Indeed, the District Court subsequently would rule that it could ignore those claims in their entirety:

> [T]he court did not address the counts brought under section 11 and 12(2) of the Securities Act of 1933 .... [T]he court ... did not, nor does it now, believe the section 11 and section 12(2) claims needed to be addressed in determining whether plaintiffs' actions as a whole warrant class certification.

Sanders v. Robinson Humphrey/American Express, Inc., [1986-87 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,880 at 94,269 (N.D. Ga. 1986) (App. E-3).

Turning to respondents' Exchange Act claims, the District Court specifically found that the case "clearly" satisfied the

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[5] Petitioners, who requested an opportunity to offer evidence at the hearing, offered only one witness—a member of their senior management—who, during cross examination, testified candidly that to his knowledge, any oral statements made to members of the class by petitioners' individual brokers during the sales transactions were entirely consistent with the prospectuses and other written sales material.

Respondents made detailed written submissions to the District Court on the class motion prior to the hearing. This included, in addition to extensive briefs, numerous items of documentary evidence and other factual material. The record also consists of documents filed with the District Court in connection with petitioners' earlier (and largely unsuccessful) dismissal motions.

"commonality" requirement of Rule 23(a)(2) of the Federal Rules of Civil Procedure, because all members of the class shared numerous common legal and factual issues relating to the prospectuses and petitioners' persistent failure to disclose material facts concerning the risks inherent in the Petro-Lewis programs. *Sanders*, 634 F. Supp. at 1056 (App. C-13). Similarly, the District Court found that the "typicality" requirement of Rule 23(a)(3) was easily satisfied in the case in light of the allegations that petitioners had engaged in a common course of conduct which affected each member of the class in the same manner. *Sanders*, 634 F. Supp. at 1057 (App. C-15).

When it reached the "predominance" element of Rule 23(b)(3), however, the District Court took an entirely different view of the case. In a totally inexplicable reversal of position, and disregarding its own findings on "commonality" and "typicality," the District Court inconsistently ruled that respondents' Section 10(b) and Rule 10b-5 claims were grounded solely upon "oral misrepresentations" between members of the class and their individual brokers—a formulation of the case which respondents' had neither pleaded nor intend to prove. The District Court adopted that characterization despite the absence from the Complaint of any allegation that respondents' claims were grounded on any such oral statements. Having thus recast the case, the District Court ruled that class certification of the Section 10(b) and Rule 10b-5 claims would be appropriate only if respondents were able to demonstrate that petitioners had engaged in a uniform "presentation" or standardized "sales pitch" directed to each and every member of the class. Finding the "evidence" on this issue to be deficient, the District Court refused to grant class action status to respondents' Exchange Act claims. *Sanders*, 634 F. Supp. at 1061-63 (App. C-23 to 27).

The District Court also ruled that the mere possibility that each member of the class might have to prove his or her individual reliance constituted a *per se* bar to class certification. *Sanders*, 634 F. Supp. at 1061, 1063 (App. C-23, 27). The District Court, therefore, focused its inquiry on whether reliance may be presumed under the "fraud on the market" theory adopted in *Shores v. Sklar*, 647 F.2d 462 (5th Cir. 1981) (*en*

banc), *cert. denied*, 459 U.S. 1102 (1983). Ignoring numerous paragraphs of respondents' Complaint which contain this *precise* allegation, the District Court held that respondents "*do not allege* that the securities would not have been sold had the misrepresentations not been present"—a necessary predicate to the *Shores* presumption. *Sanders*, 634 F. Supp. at 1063 (App. C-28) (emphasis added). Based on this and its other findings, the District Court denied class certification.

Respondents filed a timely motion for reconsideration which, in an order dated July 8, 1986, the District Court also denied. *Sanders*, [1986-87 Transfer Binder] ¶ 92,880 at 94,267 (App. Exhibit B). As they had done previously, respondents pointed out, in their motion for reconsideration, that they had, indeed, clearly and unambiguously alleged in their Complaint that "but for" the presence of the misrepresentations and omissions the partnership interests could not have been sold. Apparently mindful of its previous erroneous ruling on this issue, the District Court, in its July 8th order, shifted its analysis to an evaluation of the "support" for that allegation. The District Court conducted a selective analysis of what it considered to be the "evidence" for that allegation and determined that it was insufficient to support the theory. *Sanders*, [1986-87 Transfer Binder] ¶ 92,880 at 94,271-72 (App. B-9 to 11). However, the District Court specifically found that the issue of class certification involved several controlling questions of law about which substantial grounds existed for differences of opinion and that an immediate appeal from its two orders would materially advance the ultimate termination of the litigation. *Sanders*, [1986-87 Transfer Binder] ¶ 92,880 at 92,274-75 (App. B-17 to 19). Accordingly, the District Court certified the class issue for interlocutory appeal pursuant to 28 U.S.C. § 1292(b) (1982). The Eleventh Circuit Court of Appeals accepted the appeal in an order dated August 21, 1986 (App. Exhibit E).

In a unanimous opinion, the Court of Appeals reversed the denial of class certification with respect to respondents' federal securities law claims. The Court of Appeals ruled that the District Court had erred in refusing to give any consideration

whatsoever to possible class treatment of respondents' claims under Sections 11 and 12(2) of the Securities Act. *Kirkpatrick*, 827 F.2d at 725-26 (App. A-12 to 13).

Turning to respondents' Section 10(b) and Rule 10b-5 claims, the Court of Appeals observed that the District Court's entire analysis of the "predominance" issue was "based directly on [its] interpretation of the substance of the plaintiffs' claims." *Kirkpatrick*, 827 F.2d at 721 (App. A-4). Accordingly, the Eleventh Circuit reviewed respondents' Complaint to determine whether the District Court had properly construed those claims. The Court of Appeals concluded that the District Court had not. The Eleventh Circuit unanimously held that the District Court had "mischaracterized" the case as one involving "primarily individualized oral representations rather than a common scheme by the defendants toward the plaintiff purchasers." *Kirkpatrick*, 827 F.2d at 722, 725 (App. A-6, 11). Having placed the case in its proper context, the Court of Appeals carefully reviewed the entire record in the case, and determined that the "predominance" requirement of Rule 23(b)(3) was easily satisfied. *Kirkpatrick*, 827 F.2d at 724 (App. A-10). The Eleventh Circuit, following a long and unbroken line of authority, held that, "[i]n view of the overwhelming number of common factual and legal issues presented by plaintiffs' misrepresentation claims, . . . the mere presence of the factual issue of individual reliance could not render the claims unsuitable for class treatment." *Kirkpatrick*, 827 F.2d at 724-25 (App. A-11). The Eleventh Circuit also held that the case fell squarely within the principles announced in *Shores v. Sklar*, and that respondents were entitled to a presumption of reliance afforded by the "fraud on the market" theory recognized in that case. In so doing, the Court of Appeals ruled that the District Court could not, as it had done, base its findings on class certification "*upon nothing other*" than the District Court's assessment of the likelihood of success on the merits of respondents' claims. *Kirkpatrick*, 827 F.2d at 723 (App. A-7) (emphasis added).

Having corrected the numerous legal and factual errors which plagued the District Court's orders, the Court of Appeals

remanded the class issue to the District Court for application of the correct standards. *Kirkpatrick*, 827 F.2d at 720, 728 (App. A-2, 17).[6]

SUMMARY OF ARGUMENT

The issues raised in the Petition present no novel or unique questions of constitutional or statutory interpretation worthy of review by this Court. The decision of the Court of Appeals is firmly rooted in the precedents of this Court, follows a long and unbroken line of authority in the Eleventh Circuit, and is fully consistent with the case law in other Circuits. The alleged "conflict" which petitioners strive mightily to create is nonexistent.

REASONS FOR DENYING THE PETITION

I.

THE ISSUES RAISED IN THE PETITION ARE NOT RIPE FOR DETERMINATION WITH RESPECT TO ALL OF THE QUESTIONS PRESENTED FOR REVIEW

As noted above, the Court of Appeals neither granted nor denied class certification. Rather, the Eleventh Circuit remanded the class issue to the District Court for further proceedings consistent with its decision. Thus, the class motion remains undecided. Under these circumstances, it is unnecessary for this Court to exercise its certiorari jurisdiction at this time to render what essentially would be an advisory opinion.

In *Brotherhood of Locomotive Firemen and Enginemen v. Bangor & Aroostook R.R. Co.*, 389 U.S. 327 (1967), the Court denied a petition for writ of certiorari where the court of appeals had remanded the case to the district court for further

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[6] The other broker-dealer defendants in the companion cases to this one also have filed petitions for writs of certiorari to review the Eleventh Circuit's decision. *See PaineWebber Group, Inc. v. Parker, et al.*, No. 87-836 (petition filed November 23, 1987) and *J. C. Bradford & Co. v. Kirkpatrick, et al.*, No. 87-932 (petition filed December 7, 1987).

proceedings. In *Brotherhood,* the district court had issued a temporary restraining order against a union prohibiting a strike. The union nevertheless went on strike, and the district court entered contempt orders, imposing substantial fines for alleged violations of its restraining order. On appeal, the court of appeals ruled on many of the legal issues presented to it, but remanded the case to the district court to determine whether there had been substantial compliance with the restraining order and, if not, whether any such violation of the order was deliberate and flagrant. *Bangor & Aroostook R.R. Co. v. Brotherhood of Locomotive Firemen and Enginemen,* 380 F.2d 570 (D.C. Cir. 1967). The union sought certiorari to review the adverse rulings made by the court of appeals. This Court, noting that the court of appeals had remanded the case, held the issues were "not yet ripe for review by this Court," and denied the petition. 389 U.S. at 328.

Just as the court of appeals in *Brotherhood* did not make findings on critical issues but, rather, remanded the case to the District Court for further proceedings, so the Eleventh Circuit here did not certify a plaintiff class but, rather, remanded the case to the District Court for further findings. The issues involved in this case, as in *Brotherhood,* simply are "not yet ripe for review."

There is no particular exigency which would attend the denial of certiorari in this case. Petitioners will be free to challenge, as part of the normal appellate process after final judgment, any class which the District Court ultimately might certify in this case. In the interim, numerous developments might occur which could significantly alter or entirely moot the issues raised in the Petition. For example, the District Court might certify a class different from the class pleaded in respondents' Complaint. The District Court also may subsequently alter or amend any certification order which it might enter in this case. *See* Fed. R. Civ. P. 23(c)(1) (district court retains authority to alter or amend a class order until a "decision on the merits"). The jury may return a verdict in favor of petitioners

on the merits of respondents' claims, thereby effectively mooting all of the issues raised in the Petition.[7] The issues simply are entirely too distant and speculative to warrant review at this time.

As the Court held almost a century ago in *American Construction Co. v. Jacksonville, Tampa & Key West Ry. Co.*, 148 U.S. 372 (1893):

> Whether an interlocutory order may be separately reviewed by the appellate court in the progress of the suit, or only after and together with the final decree, is matter of procedure rather than of substantive right; and *many orders made in the progress of a suit become quite unimportant by reason of the final result or of intervening matters.* Clearly, therefore, *this court should not issue a writ of certiorari to review a decree of the circuit court of appeals on appeal from an interlocutory order, unless it is necessary to prevent extraordinary inconvenience and embarrassment in the conduct of the cause.*

Id. at 384 (emphasis added). The Court reaffirmed these principles two decades later in *Hamilton-Brown Shoe Co. v. Wolf Bros. & Co.*, 240 U.S. 251 (1916), when it stated:

> [Certiorari] is a jurisdiction to be exercised sparingly, and only in cases of peculiar gravity and general importance, or in order to secure uniformity of decision . . . . *And except in extraordinary cases, the writ is not issued until final decree* . . . . The decree that was sought to be reviewed by certiorari at complainant's instance *was not a final one, a fact that of itself alone furnished sufficient ground for the denial of the application.* . . .

Id. at 258 (emphasis added) (citations omitted). *See also* Supreme Court Rule 17.1. Here, review of the class issue should await not just a ruling on the class motion itself, but final judgment in this case.

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[7] Indeed, in that event, petitioners undoubtedly would argue in favor of maintaining a class so that they could receive the *res judicata* benefit of any such favorable decision on liability.

claims. That theory, under the circumstances of this case, is simply inapplicable to those claims.

In summary, the District Court, on remand, must reconsider the issue of class certification irrespective of the outcome of the issues raised in the Petition. Under these circumstances, granting the writ will serve merely to the delay resolution of this case without any concomitant contribution to the preservation of judicial resources. To the contrary, the judicial process will be ill-served by such piecemeal, fragmented litigation.

II.

THE DECISION OF THE COURT OF APPEALS FALLS SQUARELY WITHIN THE HOLDING OF *SHORES v. SKLAR* AND THE UNBROKEN LINE OF AUTHORITY WHICH HAS FOLLOWED IN ITS WAKE

The Court of Appeals correctly held, as has every other court which addressed the issue,[9] that a plaintiff alleging fraud under Rule 10b-5 may, in circumstances where it is alleged that

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(footnote continued)

> over the individual questions of reliance. Even if Wolf is correct in its assertion of the need for proof of reliance, and we express no views on that issue, we must still reject the argument. Carried to its logical end, it would negate any attempted class action under Rule 10b-5, since as the District Courts have recognized, reliance is an issue lurking in every 10b-5 action.

406 F.2d at 301. *Accord, In re Home-Stake Production Co. Securities Litigation*, 76 F.R.D. 351, 372 (N.D. Okla. 1977); *Sharp v. Coopers & Lybrand*, 70 F.R.D. 544, 547-48 (E.D. Pa. 1976); *Vernon J. Rockler v. Graphic Enterprises, Inc.*, 52 F.R.D. 335, 345-46 (D. Minn. 1971).

[9] *See, e.g., T.J. Raney & Sons, Inc. v. Fort Cobb Oklahoma Irrigation Fuel Authority*, 717 F.2d 1330, 1333 (10th Cir. 1983), *cert. denied*, 465 U.S. 1026 (1984); *Shores v. Sklar, supra; Arthur Young & Co. v. United States District Court*, 549 F.2d 686, 695 (9th Cir.), *cert. denied*, 434 U.S. 829 (1977); *Rose v. Arkansas Valley Environmental & Utility Authority*, 562 F. Supp. 1180, 1201-03 (W.D. Mo. 1983); *Frankel v. Wyllie & Thornhill, Inc.*, 537 F. Supp. 730, 735-37 (W.D. Va. 1982); *Dekro v. Stern Bros. & Co.*, 540 F. Supp. 406, 410-11 (W.D. Mo. 1982). *See also* Note, *Fraud On the Market—An Emerging Theory Of Recovery Under SEC Rule 10b-5*, 50 Geo. Wash. L. Rev. 627, 645-55 (1982).

securities could not have been marketed "but for" the fraud, invoke a rebuttable presumption of reliance upon the integrity of the marketplace. *Kirkpatrick*, 827 F.2d at 722-23 (App. A-6 to 7), *citing Shores v. Sklar, supra.*[10]

Reliance is generally part of the logical chain needed to establish that a defendant's misrepresentation or omission in fact caused the plaintiff's injury. *See List v. Fashion Park, Inc.*, 340 F.2d 457, 462 (2d Cir.), *cert. denied*, 382 U.S. 811 (1965). Although the requirement is easily met by showing the plaintiff's actual subjective reliance on the defendant's misstatement (*see* 3 L. Loss, *Securities Regulation*, at 1430-32 (2d ed. 1961)), courts have held that proof of such direct reliance is not necessary in certain cases, including those alleging a *Shores*-type "fraud on the market."

The "fraud on the market" theory recognized in *Shores* (and reaffirmed by the Eleventh Circuit here) is grounded on the premise that "[t]he securities laws allow an investor to rely on the integrity of the market to the extent that the securities it offers to him for purchase are entitled to be in the marketplace." *Shores*, 647 F.2d at 471. Under *Shores*, the requisite causation is provided by proof that "securities not traded on the open market could not have been issued but for a fraudulent scheme by the defendants." *Kirkpatrick*, 827 F.2d at 722 (App. A-7), *citing Shores*, 647 F.2d at 469. Allegations to that effect allow a rebuttable presumption that investors who purchased the securities and relied on the integrity of the market were harmed by the defendant's fraud.

The logic underlying the theory is manifest. If securities could not have been marketed but for a fraudulent scheme, it follows that an investor satisfies the requisite causal link by evidence that he or she purchased the securities in reliance, in whole or in part, on the integrity of the market. Indeed, as the Eleventh Circuit noted here, recognition of the "fraud on the

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[10] The Eleventh Circuit, in the *en banc* decision *Bonner v. City of Prichard*, 661 F.2d 1206 (11th Cir. 1981), adopted as precedent the decisions of the former Fifth Circuit, including *Shores*, rendered prior to October 1, 1981.

market" theory is as compelling in a *Shores*-type case as it is in a so-called "open market" [11] context:

> A *Shores* fraud-on-the-market claim thus is especially suited for class action treatment, as it makes virtually irrelevant the possibility that the various purchasers may have relied on different representations regarding the desirability of the particular security in question; all have relied on the integrity of the market in the but-for sense required by *Shores*.

Kirkpatrick, 827 F.2d at 718 (App. A-9) (footnote omitted). A similar view was expressed by the Ninth Circuit in *Arthur Young & Co. v. United States District Court, supra*, when it observed:

> Just as the open market purchaser relies on the integrity of the market and the price of the security traded on the open market to reflect the true value of securities in which he invests, so the purchaser of an original issue security relies, at least indirectly, on the integrity of the regulatory process and the truth of any representations made to the appropriate agencies and the investors at the time of the original issue.

549 F.2d at 695.

Courts have similarly accepted the common-sense observation that most investors rely on the integrity of the market in making trading decisions. As one court has observed: "It is hard to imagine that there ever is a buyer or seller who does not rely on market integrity. Who would knowingly roll the dice in

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[11] *See Basic Inc. v. Levinson*, 107 S.Ct. 1284 (1987), *granting cert. to*, 786 F.2d 741 (6th Cir. 1986). *See also Peil v. Speiser*, 806 F.2d 1154 (3d Cir. 1986); *Harris v. Union Electric Co.*, 787 F.2d 355, 367 & n.9 (8th Cir. 1986), *cert. denied*, No. 85-2036 (Oct. 6, 1986); *Lipton v. Documation, Inc.*, 734 F.2d 740 (11th Cir. 1984), *cert. denied*, 469 U.S. 132 (1985); *T.J. Raney & Sons, Inc. v. Fort Cobb Oklahoma Irrigation Fuel Authority*, 717 F.2d 1330 (10th Cir. 1983), *cert. denied*, 465 U.S. 1026 (1984); *Panzirer v. Wolf*, 663 F.2d 365 (2d Cir. 1981), *vacated as moot after cert. granted*, 459 U.S. 1027 (1982); *Ross v. A.H. Robins Co.*, 607 F.2d 545, 553 (2d Cir. 1979), *cert. denied*, 446 U.S. 946 (1980); *Blackie v. Barrack*, 524 F.2d 891 (9th Cir. 1975), *cert. denied*, 429 U.S. 816 (1976).

a crooked crap game?" *Schlanger v. Four-Phase Systems, Inc.*, 555 F. Supp. 535, 538 (S.D.N.Y. 1982). The fact that persons invest in the market at all is evidence that they rely on the assumption "that the market is not being manipulated as a result of anybody's false statement or misleading omission." *Id.*

There is no conflict on this issue in the lower courts. And the Eleventh Circuit's holding in this case is not, as petitioners suggest, a departure from any of those cases. To the contrary, it falls squarely within the holding of *Shores*. Even the so-called "critics" of the theory concede its applicability, as the Eleventh Circuit applied it here, to claims under subsections (1) and (3) of Rule 10b-5. *See* Note, *The Fraud On The Market Theory*, 95 Harv. L. Rev. 1143, 1157-58 n.56 (1982). Respondents clearly alleged that the Petro-Lewis securities could not have been marketed "but for" the fraudulent scheme, and respondents came forward with uncontroverted evidence that they relied on the integrity of the market when they made their purchases. No more is required at the class certification stage.

Petitioners' arguments simply prove too much. In the Petition they state that "any security is 'entitled to be marketed' *as long as all material information relating to it is fully disclosed*...." (Petition at 17) (emphasis added). Continuing, petitioners state that "even a security which is so lacking in prospects as to appear valueless to the reasonable investor may be 'marketed' *as long as potential investors are told the truth about it.*" (*Id.* (emphasis added)). Rounding out their discourse, they conclude: "Members of the public then are free to make their own *informed* decisions regarding whether they wish to buy what is offered." (*Id.* (emphasis added)). And that is precisely the point. Where, as here, material information is *not* " fully disclosed," investors are *not* " told the truth" about the security and, because of the foregoing, investors are *not* able to make an "informed" investment decision, liability should and does attach under Rule 10b-5. If those same investors are successful in proving at trial that full and complete disclosure of all material information would have prevented the securities from being sold in the first place (*i.e.*, rendered them "unmarketable"), and that petitioners participated in a scheme

to suppress that information, the investors have proven a violation of Rule 10b-5 (1) and (3). *See Shores,* 647 F.2d at 468-69. Among the items of evidence in this case, for example, which will be offered at trial are that critical parties to the offerings would not have participated in the syndications had the truth been known about the investments, and that insufficient funds would have been raised from subscriptions to purchase the oil reserves which constituted the partnership assets. Just as fraud can interfere with the market's pricing mechanism, it can also disrupt the issuance of "new" securities.

Critics of the *Shores* decision—including petitioners here—refer to disclaimers issued by the SEC that warn investors not to rely on the qualitative soundness of any security. This position misconstrues the remedial nature of the federal securities laws and is in conflict with the securities acts' objectives of full disclosure and investor protection. Although the SEC does not guarantee or pass judgment upon the qualitative soundness of particular securities, it would be fallacious to assume that investors are left unprotected against fraud in the issuance of those securities. The purpose of the SEC's disclaimers is to insulate the Commission against civil liability from disgruntled investors who have made poor investment decisions. Permitting an injured investor to compel the wrongdoer to compensate for the investor's losses does not interfere with that purpose and therefore should not be precluded by the disclaimers. *See* Note, *Fraud On The Market—An Emerging Theory of Recovery Under SEC Rule 10b-5,* 50 Geo. Wash. L. Rev. 627, 652-53 (1982).

Critics of the "fraud on the market" theory—including petitioners here—also fear that its test of causation extends liability under Rule 10b-5 so greatly that it may sweep in myriad plaintiffs who did not rely exclusively on "the market" in making their investment decisions. They contend that deviating from the traditional test of causation will deluge courts with vexatious litigation that cannot properly be disposed of without trials. Some are concerned that plaintiffs whose losses are unrelated to violations will nonetheless intimidate defendants into settlements, and that judicial acceptance of the theory would, in effect, encourage blackmail of large corporations.

These criticisms fail to recognize that the theory's presumptions do not require courts to impose liability more frequently or to award damages more liberally. Courts have considerable discretion in determining which plaintiffs may proceed under Rule 10b-5 and how much they may recover. For example, no group of investors can employ the theory to litigate a class action until a court certifies that group as a class. To do so, the court must find that questions of law or fact common to the group predominate over questions pertaining only to individual members, that the representative plaintiff's claims typify those of the class, and that the plaintiff will fairly and adequately protect the interests of the class. Assuming that a plaintiff class can cross these hurdles and achieve certification, a court can still limit its membership temporally, excluding investors who suffered injuries beyond the limits of a defined time period. *Id.*

Furthermore, causation is only one element of any Rule 10b-5 action. The "fraud on the market" theory does not relieve plaintiffs of the burden of proof on other issues. In addition to justifiability of reliance on the market, the independent elements of scienter, materiality, and damages remain to be established by Rule 10b-5 plaintiffs. In particular, plaintiffs' task of demonstrating by a preponderance of the evidence that the defendant intended or recklessly allowed its misinformation to defraud or deceive investors independently protects corporations and courts from the onslaught of litigation anticipated by the theory's critics—an onslaught which has never occurred.

III.

THE DECISION OF THE COURT OF APPEALS IS FIRMLY ROOTED IN WELL-SETTLED PRINCIPLES OF LAW AND PROCEDURE AND IS FULLY CONSISTENT WITH EXISTING PRECEDENT

A. The Court Of Appeals Properly Concluded That The District Court, In Ruling On A Motion For Class Certification, Was Not Permitted To Disregard The Allegations Of Respondents' Complaint And Recharacterize The Case In A Manner Which Respondents' Neither Pleaded Nor Intend to Prove

The Court of Appeals—far from according blind deference to respondents' Complaint, as petitioners suggest—merely held that the District Court could not disregard respondents' Complaint in its entirety and unilaterally reformulate respondents' case in a manner which they neither pleaded nor intended to prove. The Eleventh Circuit adopted a view of the case which *the District Court itself* had adopted in analyzing the "commonality" and "typicality" requirements of Rule 23—one grounded on a common course of fraudulent conduct which affected each member of the class in the same manner, and involving widely distributed uniform written material. The Court of Appeals held that the evidence presented both prior to and during the class certification hearing, *viewed in its proper context,* supported certification of the Section 10(b) and Rule 10b-5 claims. The Court of Appeal's decision is legally correct, factually sound, and does not merit review by this Court. One need only read respondents' Complaint (something which the District Court stated it was not required to do) to reach the same conclusion.

Petitioners have only themselves to blame for misleading the District Court through their persistent mischaracterizations of respondents' case. Such tactics frequently are employed by those who would deny any relief to a class of defrauded investors. Typical is *Shankroff v. Advest, Inc.*, 112 F.R.D. 190 (S.D.N.Y. 1986). *Shankroff* is particularly instructive, for it

involves identical claims against another brokerage firm—Advest, Inc.—which sold the Petro-Lewis partnerships. The court in *Shankroff* granted plaintiff's motion for class certification in that case and (unlike the District Court here), refused to succumb to the arguments of defense counsel that it reformulate plaintiff's case:

> Advest contends that common questions of law or fact neither exist nor predominate. Advest maintains, first, that there is no common nexus between the different Petro-Lewis partnerships, which are described in a number of different prospectuses; and second, that each potential class member's claim is distinct because the alleged frauds are based on oral, not written, representations. Thus, Advest argues, the nonuniformity of the representations characterize the issues as highly individual in nature.
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> *Advest's argument, however, mistakes plaintiff's claim.* The premise of plaintiff's complaint is that Advest, whose business consists of analyzing investment prospects and providing financial advice to its clients, engaged in a "course of conduct" designed to encourage investment in Petro-Lewis limited partnerships while failing to disclose Petro-Lewis' deplorable financial condition. Where the facts as alleged show that defendant's course of conduct concealed material information from an entire putative class, the commonality requirement is met.
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> . . . .
>
> Since plaintiff's allegations focus on overall managerial decisions which affected all Advest clients, questions of oral representations or individual reliance do not overwhelm the issues common to the class.

112 F.R.D. at 193 (emphasis added) (citations omitted). To the same effect is *In re Baldwin-United Corp. Litigation*, MDL No. 581, M21-35 (CLB) (S.D.N.Y., June 27, 1986 Memorandum Opinion and Order Granting Class Certification).[12]

[12] A copy of the decision in *Baldwin-United*, which is unreported, is included in the Appendix hereto ("Res. App.") as Exhibit A.

There, one of the same defendants involved in this case—Shearson/American Express Inc.—attempted to defeat class certification by using the same, time-worn argument that the claims in that case were grounded upon oral misrepresentations.[13] The court gave that argument short shrift:

> Plaintiffs contend that the defendants, at the corporate, policy-making level, knew or recklessly disregarding evidence of Baldwin-United's precarious financial condition . . . .
>
> . . . .
>
> The broker-dealers, for their part, deny that common issues of law and fact predominate. They maintain that the core issues submitted by plaintiffs in their complaints turn largely on oral rather than written representations, or on non-uniform documents that will require greater investigation and analysis of individual facts than class treatment will allow.
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> . . . .
>
> *This Court disagrees.* The nub of plaintiffs' claims is that material information was withheld from the entire putative class in each action, either by written or oral communication. Essentially, this is a course of conduct case, which as plead satisfies the commonality requirement of Rule 23, F.R.Civ.P. . . . Although their circumstances may vary slightly, the class members are united in attempting to establish the defendants' liability for fraudulently creating an illusion of profitability and a false sense of security when the undisclosed facts suggest otherwise.

(Resp. App. A-4 to 5)) (emphasis added) (citations omitted).

As the Eleventh Circuit specifically found, the focus of this case is on the prospectuses and other written material distributed to members of the class and on the fraudulent conduct of petitioners' senior management, *not* on any ancillary oral statements made by individual brokers employed by petitioners

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[13] The products involved in *Baldwin-United* were annuity-type securities sold to the public through petitioners' network of account executives.

to their clients.[14] Under such circumstances, courts have uniformly held that mere presence of oral statements will not render individual questions of reliance predominant over the common issues of fraud and materiality. *See, e.g., Kennedy v. Tallant,* 710 F.2d 711, 717-18 (11th Cir. 1983) ("The substance of the oral representations made by the various salesmen is not an issue in this suit."); *Esplin v. Hirschi,* 402 F.2d 94, 97 (10th Cir. 1968), *cert. denied,* 394 U.S. 928 (1969) ("[u]ndoubtedly the possibility exists that there will be questions of individual oral misrepresentations to each of the potential plaintiffs," but "having alleged .... that there was omissions and half truths common to all purchasers .... it is apparent that the issue of liability ... was to be the same as to all purchasers"); *Arthur Young & Co. v. United States District Court,* 549 F.2d 686, 695 (9th Cir.) *cert. denied,* 434 U.S. 829 (1977) (alleged reliance on oral statements was of "questionable evidentiary significance for purposes of making a Rule 23 determination" in cases involving primarily written misrepresentations); *Eisenberg v. Gagnon,* 766 F.2d 770, 786 (3d Cir.), *cert. denied,* 106 S.Ct. 342 (1985) (denial of class certification under similar facts was an "abuse of discretion"); *Sharp v. Coopers & Lybrand,* 70 F.R.D. 544, 548 (E.D. Pa. 1976) (class certified despite presence of oral statements where claims were grounded on written materials); *Fox v. Prudent Resources Trust,* 69 F.R.D. 74, 82 (E.D. Pa. 1975) (possible variations in oral statements made to limited partners in oil and gas investment programs did not defeat class certification when a fraudulent prospectus was also the basis of plaintiff's claim); *In re Home-Stake Production Co. Securities Litigation,* 76 F.R.D. 351, 369-73 (N.D. Okla. 1977) (same); *Jenson v. Continental Financial Corp.,* 404 F. Supp. 806, 813 (D. Minn. 1975) (same); *Mulcahey v. Petrofunds,* 79 F.R.D. 272, 278-80 (S.D. Tex. 1978) (same).

[14] The Eleventh Circuit also specifically found that the record in this case was devoid of any evidence that class members were even exposed to differing oral communications, let alone that any such communications "varied materially from the misleading information alleged to have been disseminated generally as a result of the defendants' common schemes." *Kirkpatrick,* 827 F.2d at 724 (App. A-10). This is uncontroverted.

These courts have adopted a common-sense approach, and recognize that it is the rare securities transaction which is not accompanied by some type of oral communication between an investor and his or her broker. Adoption of a *per se* bar to class certification whenever a securities transaction involves oral communications—the very position advocated by petitioners and adopted by the District Court here—would totally eviscerate the class action device in the securities context. It is undoubtedly for this reason that the courts have consistently rejected such an approach.

In this connection, petitioners apparently refuse to recognize the difference between "oral representations" and "oral *mis*representations." The former may be entirely consistent with the written materials and their mere presence in a case, as the Eleventh Circuit found here and as the cases cited previously uniformly hold, will not defeat certification. Oral *mis*representations, by contrast, may give rise to liability under the federal securities laws, and present a problematic situation for class certification, *if—but only if—the class' claims are grounded on those oral misstatements.* In those types of cases, the plaintiff must come forward with evidence of a standardized sales pitch in order to satisfy the requisite "commonality" and "predominance" elements of Rule 23. That is not *this* case.

B. The Court Of Appeals Did Not Ignore The Evidence At The Class Hearing But, Rather, Viewed The Entire Record In Its Proper Context

Petitioners complain that the Court of Appeals disregarded the evidence presented at the class hearing and based its decision on the class issue solely on the four corners of the Complaint. (Petition at 19-21). An examination of the Eleventh Circuit's decision belies this contention.

The Eleventh Circuit was mindful of the necessity, in particular cases, of looking beyond the face of pleadings in connection with the class action determination to see whether the requirements of Rule 23 have been satisfied. The Eleventh

Circuit's position on this issue—fully consistent with the precedents of this Court—could not be more clear:

> Certainly, as the [District Court] noted in its order, a court may look beyond the allegations of the complaint in determining whether a motion for class certification should be granted.

Kirkpatrick, 827 F.2d at 722 (App. A-7), *citing General Telephone Co. of Southwest v. Falcon*, 457 U.S. 147 (1982). Indeed, the Eleventh Circuit specifically recognized that such inquiries—such as depositions of the named plaintiffs—routinely are employed in connection with the "adequacy" and "typicality" determinations of Rule 23(a). *Kirkpatrick*, 827 F.2d at 723 (App. A-7).

Here, the decision of the Court of Appeals, on its face, reveals careful consideration of the entire record in this case, including the evidence offered at the class hearing. The Eleventh Circuit simply viewed the record differently than did the District Court, a view which gave proper recognition to the claims as pleaded by respondents, not as unilaterally reformulated by the court below at the behest of petitioners.

Furthermore, as the Eleventh Circuit specifically found, the District Court—far from conducting a simple inquiry into the merits to assist it in understanding the class issues—instead evaluated the evidence and based its class determination "*upon nothing other* than the [District Court]'s assessment of the plaintiffs' likelihood of success on the claims." *Kirkpatrick*, 827 F.2d at 723. (App. A-7) (emphasis added) (citations omitted). In essence, the District Court, at the class certification stage, demanded not merely factual support for respondents' claims, but virtually conclusive evidence of petitioners' guilt. The Eleventh Circuit properly held that such a weighing of the evidence constituted an impermissible intrusion into the merits.[15]

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[15] Such an approach, if permitted, also would fly squarely in the face of Rule 23(c)(1), which requires that the class determination be made "as soon as practicable after the commencement of an action brought as a class action. . . ." Fed. R. Civ. P. 23(c)(1).

In any event, even if the Court of Appeals, as petitioners complain, refused to look beyond the allegations of the Complaint (Petition at 20-21), such an approach would have been fully consistent with those cases which hold that the substantive allegations of the complaint must be accepted as true for purposes of ruling on a class motion. *See, e.g., Blackie v. Barrack*, 524 F.2d at 901 & n.17; *Miller v. Mackey Int'l Inc.*, 452 F.2d 424, 427-28 (5th Cir. 1971); *Green v. Wolf Corp.*, 406 F.2d 291, 294 n.1 (2d Cir. 1968), *cert. denied*, 395 U.S. 977 (1969). The correct rule was summarized in *Westlake v. Abrams*, 565 F. Supp. 1330, 1337 (N.D. Ga. 1983), where the court stated:

> If the allegations in the complaint, *which must be taken as true for purposes of demonstrating whether a class action should be granted*, allege facts which demonstrate a common and interrelated course of fraudulent conduct, any individual issues relative to facts or law are outweighed by common questions.
>
> . . . .
>
> [T]here is absolutely *no support* in the history of Rule 23 or legal precedent for turning a motion under Rule 23 into a Rule 12 motion to dismiss or a Rule 56 motion for summary judgment *by allowing the district judge to evaluate the possible merits of the plaintiff's claims at this stage of the proceedings.*

Id. (emphasis added) (citations omitted). *See also Eisen v. Carlisle & Jacquelin*, 417 U.S. 156, 177 (1974) (district court is not "to conduct a preliminary inquiry into the merits of a suit to determine whether it may be maintained as a class action"); *Seidman v. Stauffer Chemical Corp.*, [1986-87 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,868 at 94,228 (D. Conn. 1986) (allegation of common scheme or plan to defraud sufficient for ruling on class motion: "It was not necessary to establish its existence.").

CONCLUSION

For the foregoing reasons, the Petition for a Writ of Certiorari to review the decision of the United States Court of Appeals for the Eleventh Circuit should be denied.

Dated: Atlanta, Georgia
December 23, 1987

Respectfully submitted,

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APPENDIX A

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

MDL 581-IN RE BALDWIN-UNITED CORPORATION LITIGATION — M 21-35 (CLB)

MEMORANDUM DECISION
[Class Certification]

This Document Relates To:

ALFRED LINTON and JEROME W. EICHELSBACHER,
Plaintiffs,

-against-

SHEARSON LEHMAN/AMERICAN EXPRESS, INC., *et al.*,
Defendants.

83 Civ. 8476 (CLB)

VINCENT ERTL, *et al.*,
Plaintiffs,

-against-

PAINEWEBBER JACKSON & CURTIS, INC., *et al.*,
Defendants.

83 Civ. 9085 (CLB)

(caption continues)

(caption continued)

OSCAR J. WOODS, *Plaintiff,* -against- W.H. NEWBOLD'S SONS & CO., INC., *et al.* *Defendants.*	84 Civ. 2235 (CLB)
STEVEN A. PEREL, *Plaintiff,* -against- ROTAN MOSLE, INC., *et al.*, *Defendants.*	84 Civ. 8879 (CLB)

Brieant, J.

By motion fully argued and submitted on March 7, 1986, plaintiffs in this multidistrict litigation seek class certification pursuant to Rule 23, F.R.Civ.P., in each of the above-captioned four actions, which have been consolidated in this Court by transfer orders on the Judicial Panel on Multidistrict Litigation. Familiarity of the reader with all prior proceedings in this litigation is assumed, although the Court directs special attention to its decision *In Re Baldwin-United Corp.*, 105 F.R.D. 475 (S.D.N.Y. 1984), in which the Court certified tentative classes in fourteen related cases against different defendants on similar claims, for the purpose of settlement. Subsequently, a total of twenty-four consolidated class actions against that many broker-dealer defendants in the Baldwin-United securities litigation were certified and each was settled.

Plaintiffs in these four remaining actions allege that the defendant broker-dealers and Planco, Inc. engaged in a common course of fraudulent conduct in omitting material information in connection with their sales of certain investment contracts to the plaintiffs. These contracts, known as single

premium deferred annuities (SPDAs), were issued from 1979 to 1983 by two insurance subsidiaries of Baldwin-United and were marketed to the public nationwide by various means, including sale through broker-dealers such as the defendants in these four actions. In 1983, the two issuing insurance companies and four other subsidiaries that reinsured the SPDAs were placed in rehabilitation, and the parent corporation, Baldwin-United, entered bankruptcy. Thereafter, SPDA purchasers, including the class plaintiffs herein, commenced the federal civil actions that eventually were consolidated into this multidistrict litigation.

Jurisdiction is conferred over the federal law claims by Section 22 of the Securities Act of 1933 ("1933 Act"), 15 U.S.C. § 77(v), Section 27 of the Securities Exchange Act of 1934 ("1934 Act"), 15 U.S.C. § 78aa, and Section 4 of the Racketeer Influenced and Corrupt Organizations Act ("RICO"), 18 U.S.C. § 1964. The Court is likewise empowered to hear the state statutory and common law claims pleaded by virtue of diversity of citizenship and under principles of pendent jurisdiction.

The amended consolidated complaints in the *Linton, Erti* and *Woods* actions and the complaint in *Perel* each recite nine separately denominated claims for relief alleging violations of Sections 5, 12(1) of the Act, 15 U.S.C. § 78j(b) and Rule 10b-5 promulgated thereunder, and Section 1962(c) of RICO, as well as common law fraud and deceit and violations of state securities, consumer and fiduciary responsibility laws. The plaintiffs also assert claims premised on common law negligence, breach of contract and breach of fiduciary duty against all defendants except Planco, Inc. ("Planco"). Except for variations in the pleadings to account for facts peculiar to each plaintiff, the complaints are identical in all respects pertinent to these class certification motions. Therefore, the Court will not distinguish among them when examining their suitability for class certification, except as may be required to consider specific, fact-oriented arguments raised by a particular broker-dealer that call for individualized analysis.

Numerosity

In order to qualify for class action treatment, plaintiff must demonstrate that each of the four prerequisites set forth in Rule 23(a) has been satisfied and, in addition, that at least one of the factors described in Rule 23(b) is present. The first requirement, that the classes be so numerous that joinder of all the aggrieved individuals would be impracticable, is not contested here. Over several years, each broker-dealer sold SPDAs having an aggregate face value well in excess of a million dollars to purchasers throughout the country. The identity and exact number of prospective class members are ascertainable from defendants' records and those of the state rehabilitators of the issuers, and it is reasonable to conclude in view of the magnitude of this marketing effort that the number of affected persons would justify class certification.

Commonality

The second requirement, commonality, is more problematic. Under Rule 23(a)(2), plaintiffs must show that common questions of law and fact susceptible to class treatment predominate among the putative class members' claims. The gravamen of plaintiffs' complaints is that the defendants, in connection with their business of analyzing investment opportunities and providing financial services to clients, each engaged in a similar unified course of conduct to promote and sell Baldwin-United's SPDAs to the public without disclosing that the issuer was experiencing financial and regulatory difficulties. Plaintiffs contend that the defendants, at the corporate, policy making level, knew or recklessly disregarded evidence of Baldwin-United's precarious financial condition and that they elected to implement or maintain standardized marketing practices that concealed the true investment risks of the SPDAs. Those practices, plaintiffs allege, emphasized the safety, liquidity and promising investment aspects of the SPDAs even though information available to the defendants foretold Baldwin-United's collapse. Plaintiffs contend that the defendants' failure to investigate and ascertain the solidity of the SPDAs' financial backing, their practice of using uniformly deceptive promotional materials to solicit purchases, and their

failure or refusal to disclose the material omissions and half-truths embodied in their marketing strategy together caused SPDA holders to sustain substantial injury when their investments deteriorated.

The broker-dealers, for their part, deny that common issues of law and fact predominate. They maintain that the core issues submitted by plaintiffs in their complaints turn largely on oral rather than written representations, or on non-uniform documents that will require greater investigation and analysis of individual facts than class treatment will allow. For example, defendants assert, the threshold issue—whether the SPDAs are in fact securities—invites inquiry into the manner in which the SPDAs were sold and how they were described to prospective investors. Similarly, allegations of statutory and common law fraud would require the Court to make findings as to the parties' state of mind, the information disclosed, and also the fluctuating fortunes of Baldwin as of the time a particular investor made his or her purchase. The defendants therefore conclude that the highly individualized character of these transactions, affecting some 50,000 investors, makes class certification inappropriate.

This Court disagrees. The nub of plaintiffs' claims is that material information was withheld from the entire putative class in each action, either by written or oral communication. Essentially, this is a course of conduct case, which as pled satisfies the commonality requirement of Rule 23, F,R.Civ.P. *See, Green* v. *Wolf Corp.*, 406 F.2d 291, 300 (2d Cir. 1968), *cert. denied,* 395 U.S. 977 (1969). Although their circumstances may vary slightly, the class members are united in attempting to establish the defendants' liability for fraudulently creating an illusion of profitability and a false sense of security when the undisclosed facts suggest otherwise. The fact that the Planco marketing brochures may have varied slightly from broker to broker and customer to customer is not controlling here. Plaintiffs allege not that the promotional materials themselves were uniform, but rather that the information they contained—and hence that the broker-dealers disseminated—was uniformly misleading. Thus, at the very outset, the common issue of fact uniting all SPDA purchasers is

whether the Planco sales literature to which they were exposed was distorted by identical half-truths and omissions that materially affected their investment decisions. Following closely are common questions of the broker-dealers' own culpability in utilizing these materials and in failing to detect and disclose information that would have revealed the SPDAs' shaky foundations. Liability in this case does not depend on proof of the individual, face-to-face dealings between the class members and the registered representatives of the broker-dealers, and slight differences in the class members' positions will not defeat their common status as alleged victims of similar misrepresentations. *See Blackie* v. *Barrack,* 524 F.2d 801, 902 (9th Cir. 1975), *cert. denied,* 429 U.S. 816 (1976). The wrongful conduct alleged by plaintiffs occurred at the management level, if it did, and manifested itself in the defendants' course of promoting and selling the SPDAs. As a result, the relevant questions are readily susceptible to class-wide proof.

Indeed, inquiries into the actual sales process are of secondary importance. Plaintiffs are not required to establish how each and every SPDA was sold in order to prove that the SPDAs were securities. Similarly, it is not fatal to class certification that a particular investor did not receive or rely upon the contents of a Planco brochure. In a case such as this where liability would rest primarily on a failure to disclose material facts, positive proof of reliance is not a prerequisite to recovery. *Affiliated Ute Citizens* v. *United States,* 406 U.S. 128, 153-54 (1972). Similarly, the presence of oral representations or embellishments proffered by an account representative will not rend this class, even if they were the sole basis for an individual's decision to purchase an SPDA. Unlike *In Re Scientific Control Corp. Securities Ltd.,* 71 F.R.D. 491 (S.D.N.Y. 1979), and other cases where claims based on oral representations were denied class status, in this case the representations related to objective factors—the issuer's financial stability or the safety, yield and liquidity of the SPDAs—that originated from a common source: the Planco documents or the broker-dealers' alleged refusal to conduct their own investigations. *See Korn* v. *Franchard Corporation,* 456 F.2d 1206, 1212 (2d Cir. 1972). Even proof of a material variance

among the representations will not defeat the class if certain omissions, inferred from their absence in the Planco literature, were common to all. *See Esplin* v. *Hirschi*, 402 F.2d 94, 99-100 (10th Cir. 1968), *cert. denied*, 394 U.S. 928 (1969).

The defendants also argue that individual questions relating to the timeliness of certain securities claims predominate over any common issues that may exist. The Court disagrees. Camouflaged as an attack on commonality, this argument in fact invites the Court to examine and accept in the course of these class certification motions an affirmative defense that is potentially dispositive of several claims in this litigation. Such inquiry is outside the scope of Rule 23 and indeed defies the principle enunciated in *Eisen* v. *Carlisle & Jacquelin*, 417 U.S. 156 (1974), that a court may not review the substantive issues raised in a class complaint when determining the claims' suitability for class treatment. *See, e.g., Chevalier* v. *Baird Savings Association*, 72 F.R.D. 140, 150 (E.D. Pa. 1976); *see also Mersay* v. *First Republic Corporation of America*, 43 F.R.D. 465, 471 (S.D.N.Y. 1968) (class certified notwithstanding individual questions as to statute of limitations).

Accordingly, the Court concludes that common issues of fact predominate in these actions and that the requirements of Rule 23(a)(2) have been satisfied.

Typicality

The third prerequisite for maintaining a class action under Rule 23 is that the individual claims advanced by the named plaintiffs are sufficiently typical of those asserted by the class members they purport to represent. Rule 23(a)(3), F.R.Civ.P. As a general rule, a plaintiff's claim meets the typicality requirement if it arises from the same events or course of conduct that gives rise to the claims of other class members and if it is based on evidence and legal theories consistent with the other members' claims. *Dura-Bilt Corporation* v. *Chase Manhattan Corp.*, 89 F.R.D. 87, 99 (S.D.N.Y. 1981). The test, ultimately, is whether the class representative will promote the interests of the class as he protects his own.

Because this inquiry focuses on the nature of the claims asserted, factual differences involving the date, type and manner of the purchase, the investor's perception of the transaction, or even the information furnished to him at the time will not destroy typicality if each class member was the victim of the same material omissions and the same consistent course of conduct. *See Dura-Bilt, supra; Oscar Gruss & Son* v. *Geon Industries, Inc.*, 75 F.R.D. 531, 534-35 (S.D.N.Y. 1977). This is so even though, as the defendants claim, the amount and type of information available to the public changed constantly throughout the class period, and the named plaintiffs supposedly had purchased their SPDAs at a time when Baldwin-United enjoyed good financial health. The lynchpin of plaintiffs' claim is the alleged nondisclosure of material facts relating to Baldwin-United's solvency; whether the named plaintiffs can prove an actionable omission to sustain their claims invites comment on the merits, which is forbidden in the context of this class certification motion. *See Eisen*, 417 U.S. at 178. Moreover, this Court finds that the putative class representatives will have a strong incentive to develop evidence pertaining to the entire class period because their claims rely on proof of a consistent course of conduct that extended beyond the instances of alleged fraud unique to them.

Similarly, the presence of common law issues in these complaints does not destroy typicality, even though the named plaintiffs will be called upon to represent individuals of many different states if a class is certified. Common law fraud substantially includes the 10b-5 claims, and the Court can order separate hearings to resolve the question of damages, if the need arises.

Notwithstanding certain variations in proof among members of the prospective class, the Court finds that the plaintiffs have satisfied the typicality requirement by showing that the same allegedly unlawful conduct affected all members of the prospective class.

Adequacy of Representation

Finally, before certifying the named plaintiffs as class representatives, the Court must be convinced that they will fairly and adequately protect the interests of the absent class members. Rule 23(a)(4), F.R.Civ.P. Although it is not necessary that the putative representatives' claims are identical to those of the class, the constraints of due process preclude class certification if the named plaintiffs possess other, potentially conflicting interests that would impair the vigorous prosecution of the class claims. *See Hansberry* v. *Lee*, 311 U.S. 32 (1940). As set forth above, factual differences involving the sales transaction, for example, the type of promotional material used by the various account representatives and the extent to which the purchaser relied on it, will not defeat class certification. Similarly unpersuasive is the argument, also proffered above, that the plaintiffs who purchased their SPDAs early in the class period have no incentive to prove facts relevant to a purported fraud committed on a subsequent purchaser. Nor can there by any question as to the qualifications, industry and commitment of plaintiffs' counsel. All class members stand or fall on the issue whether material information was misrepresented or withheld from SPDA purchasers, and the Court believes that the named plaintiffs will pursue this issue vigorously.

The Court therefore concludes that each of the prerequisites of Rule 23(a) is satisfied. In addition, the Court finds pursuant to Rule 23(b)(3) that questions of law and fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is the superior method of adjudicating this controversy fairly and adequately.

Shearson Lehman argues that arbitration, which is available upon request to each putative class plaintiff in the Shearson Lehman track of cases, is a less expensive, more efficient—and hence superior—alternative to class litigation on certain arbitrable securities claims. Even assuming for the argument that our Court of Appeals' decision in *McMahon* v. *Shearson/American Express, Inc.*, 788 F.2d 94, 96 (2d Cir. 1986), was

wrong, *cf. Dean Witter Reynolds, Inc.* v. *Byrd*, ____ U.S. ____, 105 S.Ct. 1238, 1240 n. 1 (1985), and that Shearson Lehman enjoys, as it claims, an absolute right to compel arbitration pursuant to sales agreements it entered into with its SPDA customers, this Court does not agree that class treatment is perforce inappropriate as to those claims. The fairness and completeness of class litigation, in contrast to the scattered and fairly random solution suggested by individual arbitration, persuades this Court that fraud claims such as these are often best resolved by class action. Not only are interests of consistency, efficiency and completeness served, but there is also the assurance that most if not all potential claimants will be apprised of their rights and of the named plaintiffs' comparatively inexpensive efforts to vindicate them. This Court finds it hard to believe that any class action defendant so situated would prefer separate arbitration of each of thousands of potential claims that might otherwise be decided by class action at far less transactional cost. At least under the circumstances of this case, arbitration cannot be regarded as a serious alternative to the class action, which is so ideally suited to securities fraud claims.

The standards of Rule 23, at once fair and flexible, reaffirm the known truth that for all its pretensions, law is meant to be practical. The willingness of tweny-four sophisticated broker-dealers, advised by experienced counsel, to settle their companion actions for a record $183 million eloquently bespeaks the appropriateness of class certification among those actions that remain.

Accordingly, plaintiffs' motions for class certification in each of the four litigation tracts is granted. Each class shall be composed of those persons and entities (a) who purchased SPDAs (i) that were issued by National Investors Life Insurance Company and University Life Insurance Company of America and/or reinsured by National Investors Pension Insurance Company, Mt. Hood Pension Insurance Company, National Equity Life Insurance Company, and S & H Life Insurance Company, all of which are affiliated with Baldwin-United Corporation, and (ii) that were purchased through the respective broker-dealer defendants in each such action during

the period January 1, 1979 through July 13, 1983, each in his, her or its individual capacity and any and all collective representatives, assigns, heirs, executors, administrators, custodians, predecessors or successors in interest and any other person having any legal or beneficial interest in any of such SPDAs, and (b) who continued to hold such SPDAs on July 13, 1983.

The respective representatives of the Class as to each of the above-captioned actions shall be and hereby are certified to be as follows:

1. *Linton* v. *Shearson Lehman/American Express, Inc., et al.*, 83 Civ. 8476 (CLB), Alfred Linton and Jerome W. Eichelsbacher;

2. *Erti* v. *Paine Webber Jackson & Curtis, Inc., et al.*, 83 Civ. 9085 (CLB), Vincent Erti, Joseph and Elizabeth Chupko, George and Margaret Ledney, William Neil Aicholtz and Janet Aicholtz, and Genevieve Novicky;

3. *Woods* v. *W.H. Newbold's Sons & Co., Inc., et al.*, 84 Civ. 2235 (CLB), Oscar J. Woods; and

4. *Perel* v. *Rotan Mosle, Inc.*, 84 Civ. 8879, Steven A. Perel.

Settle a formal order on notice, which shall declare the classes as hereinbefore set forth and provide for notice and an opportunity to the members of the classes to exclude themselves.

Dated: White Plains, New York
June 27, 1986

/s/ CHARLES L. BRIEANT

Charles L. Brieant
U. S. D. J.

No. 87-835

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

ROBINSON HUMPHREY/AMERICAN EXPRESS, INC. and SHEARSON/AMERICAN EXPRESS INC.,

Petitioners,

v.

GLENN T. SANDERS and LESLIE D. SANDERS, on behalf of themselves and all others similarly situated,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

PETITIONERS' REPLY BRIEF IN SUPPORT OF THEIR PETITION FOR A WRIT OF CERTIORARI

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PETITIONERS' REPLY BRIEF IN SUPPORT OF THEIR PETITION FOR A WRIT OF CERTIORARI

Petitioners, The Robinson-Humphrey Company, Inc. and Shearson Lehman Brothers Inc., respectfully submit this reply brief to address the points raised by respondents in their brief in opposition to the petition.

Rather than addressing head-on the merits of the petition, which raises the issue of the validity of the fraud-on-the-*un*developed-market theory in class action cases brought pursuant to Section 10(b) of the Securities Exchange Act of 1934 – an issue of imperative national importance – respondents choose instead to attack the petition on the technical ground that the case is not "ripe" for this Court's review merely because the Eleventh Circuit "neither granted nor denied class certification" (Respondents' Brief at 12) and remanded the case back to the district court to make that determination.

In light of the overriding import of the substantive issue presented by the petition, respondents' "ripeness" argument must fail. The issue of the validity of the fraud-on-the-*un*developed-market theory presents a clear-cut legal question which is fundamental to the further conduct of this action as well as to a plethora of other securities cases brought on a nationwide scale. Thus, the issue merits Supreme Court review irrespective of the procedural posture of this case; otherwise, the issue would continue to evade review as it has done before.

With this Court's granting of certiorari in *Basic Inc. v. Levinson* to address the validity of the fraud-on-the-developed-market theory, it makes utmost sense for the Court to address the issue raised in the instant petition – the validity of that doctrine's application to *un*developed markets – at the same time. Petitioners respectfully submit that it would be inordinately inefficient and counter-productive to allow the points raised in this petition to remain unaddressed when all aspects of the fraud-on-the-market theory could be resolved with finality.

ARGUMENT

THE FRAUD-ON-THE-*UN*DEVELOPED-MARKET ISSUES RAISED IN THE PETITION WARRANT THIS COURT'S IMMEDIATE PLENARY REVIEW NOTWITHSTANDING THE INTERLOCUTORY POSTURE OF THIS CASE

The thrust of respondents' opposition brief is the argument that certiorari should be denied and review of the fraud-on-the-*un*developed-market issues should be "postponed" until a final

judgment has been entered in this case. In advancing this position, however, respondents bypass the fact that insisting on final judgment as a prerequisite to review will mean, in all likelihood, that these critical issues will not be reviewed for many years, if ever. Notably, even respondents do not contest the overriding national importance of the question of the fraud-on-the-*un*developed-market doctrine's validity, its pervasive application in major securities class actions, and the fact that most such cases never reach final judgment due to the *in terrorem* effect of their sheer size, which forces most cases presenting this issue to settle irrespective of their lack of substantive merit. These considerations warrant issuance of the writ notwithstanding the interlocutory posture of the case.

A. *This Court Has Jurisdiction To Review Interlocutory, As Well As Final, Determinations*

Respondents' brief asserts, in substance, that certiorari must be denied on the basis of the procedural posture of this case. To the contrary, however, this Court has the discretion to grant certiorari to review judgments of federal courts of appeals, irrespective of the procedural posture of the case below. Thus, where

> there is some important and clear-cut issue of law that is fundamental to the further conduct of the case and that would otherwise qualify as a basis for certiorari, the case may be reviewed despite its interlocutory status.

R. Stern, E. Gressman & S. Shapiro, *Supreme Court Practice* 225 (6th ed. 1986).

Indeed, this Court frequently has exercised its discretionary jurisdiction in such cases despite their nonfinal posture. *See, e.g., Nixon v. Fitzgerald*, 457 U.S. 731, 743 (1982) (petitioner raised " 'serious and unsettled' question"); *Gillespie v. United States Steel Corp.*, 379 U.S. 148, 153 (1964) (questions presented were " 'fundamental to the further conduct of the case' ").

In light of this authority, respondents' broad and hypothetical references to the alleged potential pitfalls of interlocutory review are inapposite. As demonstrated below, those illusory concerns are far outweighed by the numerous factors militating in favor of review on certiorari.

B. *Substantially Identical Issues Are Currently Pending Before This Court In The* Basic Inc. *Action*

Inexplicably, respondents ignore *Basic Inc. v. Levinson*, 107 S. Ct. 1284 (1987), *granting cert. to* 786 F.2d 741 (6th Cir. 1986).[1] Respondents say not a word about *Basic Inc.* despite the fact that Point I of the instant petition is devoted to that companion case, and despite the fact that this Court's grant of certiorari in *Basic Inc.* is itself sufficient to warrant certiorari here.

> Where the petition for certiorari presents a question that is identical with, or similar to, an issue already pending before the Supreme Court in another case in which certiorari had been granted, the issue is obviously important and the Court will either grant the petition and set the case for argument, or postpone consideration of the petition until the other case has been decided and then make summary disposition of the case in accordance with that decision.

R. Stern, E. Gressman & S. Shapiro, *Supreme Court Practice* 221 (6th ed. 1986). The interlocutory posture of this case does not render the fraud-on-the-market issues raised herein any less important or any less "certworthy" than those already identified as such in *Basic Inc.* Indeed, if the "traditional" fraud-on-the-market theory is sufficiently controversial to merit the granting of a writ of certiorari in *Basic Inc.*, then *a fortiori* the extension of that theory by the Eleventh Circuit in the instant case to *undeveloped* markets, despite the absense of any justification for

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[1] Respondents' sole reference to the *Basic Inc.* action is in a string citation of cases adopting the fraud-on-the-market theory in the open-market context. (*See* Respondents' Brief at 18 n.11.)

its application on economic or legal grounds, warrants the granting of the instant petition.

C. *The Fraud-On-The-Undeveloped-Market Questions Raised By The Petition Are Clear-Cut Legal Issues Fundamental To The Further Conduct Of This Action*

This petition is an exceptionally compelling vehicle for review of the fraud-on-the-*un*developed-market doctrine. In reversing the trial court's denial of class certification of respondents' Rule 10b-5(1) and (3) claims, the Eleventh Circuit embraced *Shores v. Sklar*, 647 F.2d 462 (5th Cir. 1981) (*en banc*), *cert. denied*, 459 U.S. 1102 (1983), and expressly overturned the lower court's "rejection of the fraud-on-the-market theory as a basis for class action treatment" of those claims. (*See* Appendix to Petition, filed Nov. 23, 1987, at A-6.) Indeed, the Eleventh Circuit's application of the *Shores* doctrine to those claims provided the dispositive ground for that court's reversal of the district court's holding.

Thus, contrary to respondents' characterization, an opinion rendered by this Court on certiorari in this action would be anything but "advisory." (Respondents' Brief at 12.) The questions raised by the fraud-on-the-*un*developed-market doctrine in the context of this case are neither abstract, hypothetical, nor contingent. The court below adopted the doctrine as the law of the Eleventh Circuit and the case, and in the absence of that holding the district court's denial of Rule 10b-5(1) and (3) certification surely would be reaffirmed on remand. Thus, if the class is to pursue those subsection (1) and (3) claims, it can do so only on a fraud-on-the-*un*developed-market theory.[3]

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[3] Respondents' argument that the petition should be denied on the ground that "the 'fraud on the market' theory is not implicated at all with respect to several of respondents' other claims" (Respondents' Brief at 15), is a *non sequitur*. Given the fact that the Eleventh Circuit grounded its Rule 10b-5(1) and (3) holding on the fraud-on-the-*un*developed-market doctrine, that doctrine will play a fundamental role in the trial-level proceedings unless the class chooses to abandon those claims. The existence of other counts in the complaint is wholly irrelevant.

Manifestly, the validity of the fraud-on-the-*un*developed-market doctrine is a question fundamental to the course and disposition of this action. Moreover, the Court can reach the issue without wading through a factual morass – indeed, without resolving a single disputed question of fact. The clarity of the issue will not be enhanced by further development of the record on remand.

Respondents' speculations of prospective mootness (*see* Respondents' Brief at 13-14) also do not diminish the propriety of plenary review at this time. One such scenario raised by respondents, an ultimate verdict for petitioners on the merits, is not only remote in time, but, if considered by this Court to be a serious obstacle to review on certiorari, would have precluded the Court from hearing the majority of the important interlocutory cases which it has in fact entertained in the past and would severely impede this Court's review of important issues.

Historically, the Court has not considered the potential for ultimate victory by the petitioner to be the obstacle to certiorari that respondents hold it out to be, certainly not where the legal issues raised in the petition are as important as they are here. For example, the fact that petitioners in *General Telephone Co. v. Falcon*, 457 U.S. 147, 155 (1982), might ultimately have been successful in defending that suit did not dissuade this Court from granting "certiorari to decide whether the class action was properly maintained" even while the merits of the respondents' claims "remain[ed] open for reconsideration in the District Court on remand . . . ." By way of further example, this Court recently reviewed on certiorari an interlocutory holding by the Second Circuit that arbitration agreements were unenforceable as to RICO and Rule 10b-5 claims. *Shearson/American Express, Inc. v. McMahon*, 107 S. Ct. 2332 (1987). The *McMahon* petitioners' writ was granted despite the possibility that, had the claims been tried to a jury, the arbitrability issue may have been mooted by a verdict for the petitioners.

Similarly unpersuasive is respondents' assertion (*see* Respondents' Brief at 13) that the fraud-on-the-*un*developed-market issue is not ripe for review because it could be rendered moot

by the character of any class ultimately certified or by subsequent district court modification of any such certification order. First, the composition or recomposition of any class will not moot the fraud-on-the-*un*developed-market issues as long as any claims based on that doctrine are allowed to proceed.[3]

Second, if respondents are suggesting that the trial court might ultimately bar class prosecution of respondents' fraud-on-the-*un*developed-market claims, that scenario would be substantially identical to that of a trial verdict for petitioners. Neither hypothetical scenario is relevant to the granting of the requested writ if, as is the case here, the issue of law presented is clear-cut, fundamental to the proceeding, and otherwise certworthy. *See supra* p. 3.

D. ***The Imperative National Importance Of The Fraud-On-The-Undeveloped-Market Questions Warrant Issuance Of A Writ Regardless Of The Interlocutory Status Of The Action***

The petition sets forth in detail why the fraud-on-the-*un*developed-market doctrine lacks a principled basis in law or economics, how the doctrine nevertheless effects an unreasonable abandonment of the Rule 10b-5 reliance requirement without providing an adequate replacement link in the chain of causation, and how the doctrine therefore has been justifiably questioned and criticized. The petition also shows how the application of the doctrine to undeveloped markets actually conflicts with the rationale underlying its developed-market counterpart as well as with the developed-market theory's provisions for the rebuttal of any presumed reliance based on that theory.

Respondents' brief ignores or glosses over these and the other points raised in the petition, but cannot obscure the national importance of the issues presented therein. This becomes obvious upon examination of the arguments that respondents attempt

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[3] Likewise, if petitioners were to challenge successfully the adequacy of respondents as class representatives, that event would not moot the fraud-on-the-*un*developed-market issues because respondents presumably would continue to pursue such claims in their individual capacities.

to raise with respect to those issues, and the points raised in the petition which they ignore.

First, respondents advance the same "unmarketability"/but-for causation analysis (*see, e.g.*, Respondents' Brief at 16-17) discredited in the petition (*see* Petition at 16-18). For example, in support of that analysis, respondents quote *Arthur Young & Co. v. United States District Court*, 549 F.2d 686, 695 (9th Cir.), *cert. denied*, 434 U.S. 829 (1977), for the proposition that

> the purchaser of an original issue security relies, at least indirectly, on the *integrity of the regulatory process* and the truth of any representations made to the appropriate agencies . . . at the time of the original issue.

(Respondents' Brief at 18 (emphasis added).)

Reliance on the regulatory process, however, is not an adequate replacement for actual reliance on misstatements, for reasons which respondents themselves provide: "the SEC does not guarantee or pass judgment upon the qualitative soundness of particular securities . . . ." (Respondents' Brief at 20.) It would be unsound policy to sanction, as a matter of law, an investor's claim that he relied on the regulators to perform tasks they in fact do not perform; such reliance, if real, would be unreasonable. Moreover, since the regulators do not evaluate the intrinsic soundness of a security, they simply cannot provide a causal link between an alleged fraud and an investor who was injured by purchasing a so-called "unmarketable" security.

Second, respondents fail to dispose of the conflict inherent in the application of the fraud-on-the-market theory to undeveloped markets: the efficient market hypothesis, which is the theoretical underpinning of the fraud-on-the-developed-market doctrine, is inoperative by definition in the context of undeveloped, inefficient markets.[4]

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[4] With regard to the conflict created by the Eleventh Circuit's rejection of the rebuttal options afforded defendants in developed-market contexts,
(footnote continued on next page)

In short, respondents' points in opposition fail to diminish the importance of the issues presented by the petition, an importance manifested by this Court's decision to hear substantially identical issues in the developed-market context of *Basic Inc.*

E. *Denial Of The Petition Would Disserve Judicial Efficiency And Unnecessarily Avoid Resolution Of A Recurring Issue Which Evades Review*

Respondents propose that petitioners' challenge to the fraud-on-the-*un*developed-market doctrine be made "as part of the normal appellate process after final judgment . . . ." (Respondents' Brief at 13.) There is irony in this stance given the fact that it was respondents who deviated from the "normal" appellate process by seeking and gaining interlocutory review in the first instance. But even placing that aside, their position is ill-considered, for the postponement they advocate would be highly inefficient and counter-productive to the further conduct of this and other Rule 10b-5 class action cases.

The eventual costs of this action "will certainly be less if [the Court] pass[es] on the questions presented here rather than send the case back with those issues undecided." *Gillespie v. United States Steel Corp.*, 379 U.S. 148, 153 (1964). More important, however, will be the savings in time and other resources throughout the judiciary nationwide. The fraud-on-the-market doctrine historically has evaded this Court's review despite its recurring presence in the courts below. This petition represents

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(footnote continued from previous page)

respondents simply ignore the conflict. They do state at one point that the Eleventh Circuit sanctioned a "rebuttable" presumption of reliance, but that is a misstatement. (*See* Petition at 14-16.) So, too, is respondents' assertion that "[e]ven the so-called 'critics' of the theory concede its applicability, as the Eleventh Circuit applied it here, to claims under subsections (1) and (3) of Rule 10b-5. *See* Note, *The Fraud On The Market Theory*, 95 Harv. L. Rev. 1143, 1157-58 n.56 (1982)." (Respondents' Brief at 19.) In this instance, respondents misrepresent the author's views. The footnote cited merely elaborates on an argument which the author identifies as one arguable "rationale" for the *Shores* decision, an argument he then expressly rejects as "not convincing." 95 Harv. L. Rev. at 1157-58.

the undeveloped-market complement to the *Basic Inc.* action, and thus affords the Court a timely opportunity to address the fraud-on-the-market doctrine in full. The judicial efficiencies which would attend such a determination merit the granting of the petition herein.

CONCLUSION

For all of the foregoing reasons, petitioners respectfully urge the Court to grant their petition.

Dated: New York, New York
December 31, 1987

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Supreme Court, U.S.
FILED
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CLERK

No. 87-835

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

ROBINSON HUMPHREY/AMERICAN EXPRESS, INC.
and SHEARSON/AMERICAN EXPRESS, INC.,
Petitioners,

vs.

GLENN T. SANDERS and LESLIE D. SANDERS,
on behalf of themselves and all others similarly situated,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

RESPONDENTS' SUPPLEMENTAL BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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INTRODUCTION

Respondents Glenn T. Sanders and Leslie D. Sanders ("respondents"), pursuant to Supreme Court Rule 22.6, respectfully submit this supplemental brief in opposition to the pending Petition for a Writ of Certiorari (the "Petition") filed by Robinson Humphrey/American Express, Inc. and Shearson/American Express, Inc. ("petitioners") in order to bring to the attention of the Court a recent decision of the United States

District Court for the Southern District of New York which bears directly on the issues raised in the Petition. This new case further supports respondents' argument—previously asserted in our opposing brief—that the Petition raises no novel or unique questions of constitutional or statutory interpretation or policy matters worthy of review by this Court. Accordingly, the Petition should be denied.

THE *BRESSON* CASE

In *Bresson v. Thomson McKinnon Securities Inc.*, 85 Civ. 1179 (GLG) (S.D.N.Y., January 19, 1988 Opinion and Order granting class certification),[1] the court granted plaintiffs' motion for class certification in a case involving identical claims against another brokerage firm—Thomson McKinnon Securities Inc. ("TMSI")—which sold the Petro-Lewis partnership interests involved in the present case. The *Bresson* court found that plaintiffs' Section 10(b) and Rule 10b-5 claims in that case were particularly suited for class treatment in light of the allegations that "the defendant [had] engaged in a common course of conduct to withhold and conceal material information from the class." (App. at 7a). Rejecting TMSI's argument that the purported presence of allegedly non-uniform and highly individualized oral misrepresentations destroyed the "predominance" element of Rule 23(b)(3), the court found that the offending "omissions and half-truths related to objective factors such as Petro-Lewis' and the partnerships financial viability" which, even if not identical, nevertheless were "uniformly misleading." (App. at 7a). In any event, according to the court, the claims in the case were not grounded on any such oral misrepresentations, and there was nothing in the record to indicate that any such oral statements, which arose out of uniform written documents, "were not materially similar. . . ." (App. at 7a).

[1] A copy of the *Bresson* decision, which as of this date is not reported, is included in the Appendix hereto ("App.") as Exhibit A.

ARGUMENT

I. THE *BRESSON* CASE FURTHER UNDERMINES THE ARGUMENTS RAISED IN THE PETITION

In our initial opposing brief, we demonstrated that the unanimous decision of the Eleventh Circuit under attack by petitioner here is firmly rooted in well-settled principles of law and procedure and is fully consistent with existing precedent —including other cases which involved virtually identical claims arising out of the Petro-Lewis debacle. Every court which has decided this particular issue—first the district court in *Shankroff v. Advest, Inc.*, 112 F.R.D. 190 (S.D.N.Y. 1986), then the Eleventh Circuit here, and now the court in *Bresson*—has ruled that Section 10(b) and Rule 10b-5 claims against brokerage firms which participated in Petro-Lewis' "Ponzi scheme" [2] are appropriate for class treatment. There is no conflict on this issue. To the contrary, the cases are consistent and uniform in both their reasoning and result. And they are fully consistent with the long and unbroken line of authority in securities class action jurisprudence which holds that where, as here, claims of thousands of small investors are grounded on virtually identical prospectuses and arise from a protracted and pervasive course of misconduct at the highest levels of corporate management, those claims may—and should—be determined on a classwide basis.

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[2] *See* App. at 4a.

CONCLUSION

For the foregoing reasons, and for the reasons set forth in our opposing brief, the Petition for a Writ of Certiorari to review the decision of the United States Court of Appeals for the Eleventh Circuit should be denied.

Dated: Haverford, Pennsylvania
February 3, 1988

Respectfully submitted

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APPENDIX A

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

JEROME BRESSON and FRANKLIN M. BROWN, on behalf of themselves and all others similarly situated,
Plaintiffs,

-against-

THOMSON MCKINNON SECURITIES INC.,
Defendant.

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85 Civ. 1179 (GLG)
OPINION

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GOETTEL, D.J.:

The named plaintiffs, Jerome Bresson and Franklin Brown, seek to represent certain investors injured by alleged violations of Section 10 of the Securities Exchange Act of 1934, 15 U.S.C. § 78j (1982), and Rule 10b-5, 17 C.F.R. § 240.10b-5 (1987). The plaintiffs also make allegations of common-law negligence, fraud, and breach of fiduciary duty.

The defendant, Thomson McKinnon Securities, Inc., is a dealer and broker of corporate securities, and was an underwriter of the securities in question here.

Before us is the plaintiffs' motion for class certification. The putative class consists of all persons who during the period January 1, 1981 through and including February 6, 1984 purchased from the defendant interests in the following limited partnerships: the Petro-Lewis Oil Income Programs, the Petro-Lewis Oil and Gas Income Programs, and the Petro-Lewis Deferred Income Program. Excluded from this class are: the defendant and the Petro-Lewis Corporation; their respective affiliates, officers, directors and employees; and corporations, trusts or entities controlled by any of the foregoing.

Background

At the time pertinent to this action, the Petro-Lewis Corporation was an independent producer of oil and gas, and a manager of petroleum investments for public investors. On an approximately monthly basis, Petro-Lewis formed limited partnerships, the stated objectives of which were to purchase producing oil and gas properties. These limited partnerships were marketed to the public nationwide by various means, including sale through brokers such as the defendant Thomson. Petro-Lewis acted as a general partner in each of these limited partnerships.

Because of various poor business practices, such as the excessive leveraging of the partnership properties, and because of the declining price of oil during 1981 and 1982, the viability of Petro-Lewis, and of the limited partnerships, deteriorated. As the company's debt obligation continued to grow, and oil prices declined, the company came to face a cash squeeze. This

situation was worsened by the fact that limited partners had a right to sell their investments back to Petro-Lewis. As more and more of them did so, the company's cash squeeze tightened further. In the face of this crisis, Petro-Lewis continued to make distributions to the limited partners. Although this course of action further drained available cash, Petro-Lewis had a strong interest in maintaining these distributions. By continuing the distributions, Petro-Lewis created an image of "business as usual" in the face of serious problems. This image was important to the company, because it maintained the attractiveness of investments in the limited partnerships. The continued attractiveness of the partnerships was crucial because the company was relying on continued sales of the investments to meet the company's demand for cash. The company also relied on further borrowing to meet this demand. In essence, Petro-Lewis was operating a sort of "Ponzi" scheme.

Finally, in February 1984, Petro-Lewis publicly acknowledged that its partnership syndication operation was in serious financial trouble. Thereafter, Petro-Lewis investors filed several class action lawsuits in the United States District Court for the District of Colorado against the directors of Petro-Lewis and against certain Petro-Lewis entities, to recover for their substantial losses. That court approved a settlement of eleven consolidated class actions for investors in the limited partnerships formed by Petro-Lewis between August 1975 and February 1984. Pursuant to the settlement agreement, the defendants in that case were released from liability in return for the formation of a royalty trust and a settlement fund valued at $23.5 million.

The broker-dealers who sold interests in the partnerships were specifically excluded from the releases executed in the Petro-Lewis litigation. Several individual and putative class actions against these broker-dealers followed, including the one at bar.

Approximately six months after the initial complaint in this case was filed, the Securities and Exchange Commission filed a complaint against Petro-Lewis alleging violations of Sections 17(a) (1), (2), and (3) of the Securities Act of 1933. In its

complaint, the SEC charged that Petro-Lewis had misrepresented the performance of its existing oil and gas partnerships and the operations that future oil and gas partnerships would have, that it had misrepresented the profitability, safety, and liquidity of investments in the partnerships, and that it had purposefully presented an appearance of sound financial condition and "business as usual" when in fact it was experiencing serious debt and cash flow problems. The SEC also charged that several of Petro-Lewis' public statements concerning material corporate and partnership events were misleading because Petro-Lewis made technical and piecemeal disclosures of some facts and omitted others.

Against this background, the plaintiffs allege the following. The various prospectuses and other sales materials pursuant to which the defendant sold the investments varied somewhat, but were uniformly misleading in that they failed to disclose the true risks of the investments. They allegedly failed to disclose, *inter alia,* that partnership distributions were funded from loans rather than operations, that the partnership properties were excessively leveraged, or that Petro-Lewis' accounting procedures were questionable.

The plaintiffs allege that the defendant knew or should have known of the true financial state of Petro-Lewis and of the partnerships and knew or should have known that they were not viable. Moreover, the plaintiffs allege, the defendant knew that the prospectuses and sales material underlying the partnerships failed to disclose the precarious financial condition of the company and the partnerships and thus failed to disclose the true risk of the investment. They allege that notwithstanding this knowledge the defendant failed to disclose this knowledge to the investors and indeed intentionally concealed the risk of the investments from them.

Discussion

Before we can certify a class in this case, we must determine that all of the prerequisites of Rule 23(a) have been satisfied, and that at least one of the elements of Rule 23(b) is present.

A. Numerosity

The first requirement of Rule 23(a) is that the class be so numerous that joinder of all aggrieved individuals would be impracticable. Fed. R. Civ. P. 23(a)(1). The plaintiffs allege that the instant class consists of hundreds, and possibly thousands, of individuals. Such numbers satisfy the numerosity requirement. *See Korn v. Franchard Corp.*, 456 F.2d 1206, 1209 (2d Cir. 1972).

However, there is the possibility that some class members may be subject to arbitration agreements. The Supreme Court recently upheld the enforceability of agreements requiring the arbitration of Rule 10b-5 claims. *Shearson/American Express Inc. v. McMahon,* ____U.S.____, 107 S. Ct. 2332 (1987). Thus if the number of class members subject to such agreements is sufficiently large, and if the defendant chooses to compel arbitration of their claims, it could be that the remaining number of class members would not satisfy the numerosity requirement. However, the defendant has not pressed an argument that a large number of class members is subject to arbitration agreements, nor has it argued how many of those it would in fact compel to go to arbitration. Therefore we may assume that the number is not sufficiently large. If later developments show that the number is in fact sufficiently large so that the numerosity requirement is not met, then of course we are authorized to decertify the class pursuant to Fed. R. Civ. P. 23(c)(1) and (d)(4).

B. Commonality

The second prerequisite of Rule 23(a) is that there exist questions of law or fact common to the class. Fed. R. Civ. P. 23(a)(2). Thomson does not dispute that this element is satisfied. However, Thomson argues that such common questions do not predominate over questions affecting only individual members of the class and that therefore the case cannot be maintained as a class action under Rule 23(b)(3).

The defendant argues that issues of reliance, which depend on individualized proof, predominate. We disagree. Although the plaintiffs' case involves a certain number of affirmative

misrepresentations, the gravamen of their complaint is that the defendant engaged in a common course of conduct to withhold and conceal material information from the class. Their claim is that the defendant conspired with Petro-Lewis to present an image of "business as usual" and failed to disclose and indeed concealed material facts that would have shown that image to be an illusion. Thus, the plaintiffs present a course of conduct case which as pled satisfies the commonality requirement of Rule 23. *See Kirkpatrick v. J.C. Bradford & Co.*, 827 F.2d 718, 724-25 (11th Cir. 1987)(appeal of three companion cases against other brokers, arising from the Petro-Lewis litigation); *see also Green v. Wolf Corp.*, 406 F.2d 291, 300 (2d Cir. 1968), *cert. denied*, 395 U.S. 977 (1969).

Our conclusion that common issues predominate is not altered by the defendant's argument that the prospectuses were not identical, and that Thomson's account representatives' discussions with class members likely varied. Notwithstanding the alleged differences among these various communications, there is nothing to indicate that they were not materially similar insofar as all of them contained the same omissions and half-truths. Moreover, the alleged omissions and half-truths related to objective factors such as Petro-Lewis' and the partnerships' financial viability, or the safety and yield of the partnerships. Finally, the alleged misrepresentations originated from a common cause, namely Thomson's alleged failure either to conduct or to heed its own investigation of Petro-Lewis. Thus although the communications to class members may not have been uniform, they allegedly were uniformly misleading. The variations are therefore immaterial and will not defeat class certification. *Kirkpatrick*, 827 F.2d at 724-25; *In re Baldwin-United Corp. Litigation*, No. M 21-35, opinion at 8 (S.D.N.Y. Jun. 27, 1986) (Brieant, J.) (available on WEST-LAW) ("Even proof of a material variance among the representations will not defeat the class if certain omissions, inferred from their absence in the . . . literature, were common to all.").

The defendant also claims that individual issues predominate because each class member's damages will differ. However, given the fact that issues pertaining to liability are predominantly common, rather than individual, the fact of

individual issues as to damages will not defeat the class. *Dura-Bilt Corp. v. Chase Manhattan Corp.,* 89 F.R.D. 87, 93 (S.D.N.Y. 1981). If necessary, the Court can order separate trials on the question of damages. *Green,* 406 F.2d at 301.

With respect to the plaintiffs' state-law claims for fraud, breach of fiduciary duty, and negligence, the defendant makes further arguments against certification. First, it argues that common issues do not predominate with respect to these claims because different state laws apply with respect to a credit based on the Colorado settlement against Petro-Lewis. This argument is addressed to the issue of damages, which we have treated above.

Next, the defendant points out that varying state laws may govern liability on the common-law claims, *see Phillips Petroleum Co. v. Shutts,* 472 U.S. 797 (1985), and that differing standards of liability obtaining under the several state laws will render class treatment of those claims unmanageable. For this reason, the defendant argues that with respect to the state-law claims, common issues of law do not predominate. With respect to the claims for fraud and breach of fiduciary duty, we disagree with the defendant's position and find these claims amenable to class treatment. The state laws governing these claims do not vary significantly, since common principles underlie them. *See In re Lilco Securities Litigation,* 111 F.R.D. 663, 670 (E.D.N.Y. 1986) (citing W. Prosser, The Law of Torts §§ 105-110 (1971 4th ed.)) (fraud). Moreover, the elements of at least the fraud claim will, for the most part, be established by proof of the federal claims. *See In re Baldwin-United Corp. Litigation,* opinion at 11.

We come to a different conclusion regarding the plaintiffs' claims for negligence. The state laws governing these claims do vary significantly, particularly with respect to the defenses of contributory negligence, comparative negligence and assumption of risk. The common-law negligence claims are therefore unsuited to class treatment.

C. Typicality/Adequacy

Rule 23 also requires that the claims or defenses of the representative parties be typical of those of the class, and that

the class representative be one who will fairly and adequately protect the interests of the class. Fed. R. Civ. P. 23(a)(3) and (4). The defendant argues that the plaintiff Brown is subject to a unique defense because he placed great confidence in his broker, Mr. Hallquist, and relied on his recommendations. Thomson claims further that the fact that Brown thought it a "plus" that Hallquist also invested in Petro-Lewis somehow makes Brown's relationship with his broker "quite special." Finally, on the basis of Brown's statements to the effect that he did not read the sales literature with great care, and that some of it confused him, the defendant surmises that Brown in fact relied exclusively on Hallquist's oral advice, and not at all on any of the sales literature sent to him. The defendant's arguments are not well taken, for the following reasons.

We see nothing unusual in the fact that an investor consulted his broker with respect to an investment the size of Brown's. Nor does the fact that Brown placed confidence in his broker make him atypical. Presumably, one should only use a broker in whom one does have confidence.

Moreover, we note that the defendant has not alleged that Hallquist gave Brown material information omitted from the sales material, so that one could not fairly say that Brown could have been deceived by its omission in the literature. This point is important since this case is based primarily on omissions rather than affirmative misrepresentations.

Finally, the defendant does not dispute that in fact Brown did read some of the literature. We have considered the defendant's other arguments concerning Brown on this issue, and find them to be without merit.

The defendant also argues that Bresson, Brown's co-plaintiff, is subject to several defenses which are atypical of the class. Thomson suggests that the fact that Bresson consulted several high-level Thomson personnel about his investment renders him atypical of the class, whose complaint rests on the prospectus and other sales literature. We disagree. The defendant does not suggest that these discussions clarified the half-truths in the literature supplied to Bresson, or supplied information omitted from the literature, so that Bresson could not fairly be said to have relied on those half-truths and

omissions. Bresson's discussions therefore do not make him atypical of the class. *See supra* p. 7. Bresson remains united with the other class members "in attempting to establish the defendant['s] liability for fraudulently creating an illusion of profitability and a false sense of security when the undisclosed facts suggest otherwise." *In re Baldwin-United Corp. Litigation,* opinion at 6-7.

Thomson also attacks Bresson's typicality on the basis that his and his broker's wives are cousins. We find this relationship too distant to affect the issue of Bresson's adequacy as a class representative. *Contra, Shankroff v. Advest, Inc.,* 112 F.R.D. 190, 194 (S.D.N.Y. 1986) (holding that an identical relationship indicated atypical issues of reliance and a potential conflict of interests).

D. Superiority

In addition to satisfying the requirements of Rule 23(a), the plaintiffs must demonstrate that at least one of the elements of Rule 23(b) is also satisfied. The pertinent section of Rule 23(b) here is Rule 23(b)(3). We have already addressed the first requirement of this rule, which is that common questions of law or fact must predominate. We now turn to the second requirement, which is that a class action be superior to other available methods for the fair and efficient adjudication of the controversy.

We note that the average investment at stake here is approximately $8,600.00. This amount would probably not be deemed sufficient to justify individual litigation. This fact supports the conclusion that a class action is a superior method for achieving an efficient adjudication of the matters in controversy.

Another consideration bearing on the superiority of class treatment concerns the manageability of the action as a class action. On this point, the defendant's arguments largely go to issues which concern the merits of the plaintiffs' claims. Such substantive issues are not proper subjects for review on a motion for certification. *Eisen v. Carlisle & Jacquelin,* 417 U.S. 156 (1974). To the extent that the defendant's manageability arguments concern the common-law issues, we have discussed them above.

CONCLUSION

For the reasons discussed above, the motion for certification is granted, except that certification as to the claims for negligence under the common law is denied.

SO ORDERED.

Dated: White Plains, N.Y.
January 19, 1988

GERARD L. GOETTEL

GERARD L. GOETTEL
U.S.D.J.